COUNCIL AGENDA: 12/2/08
ITEM: 3.6

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Paul Krutko
Peter Jensen

SUBJECT: CITY HALL RETAIL

DATE: November 10, 2008

Approved

Date 11/10/08

COUNCIL DISTRICT: 3

RECOMMENDATION

Approval to issue a Request for Proposals (RFP) to select a developer for the vacant space on the ground floor of City Hall on 4th Street.

OUTCOME

Approval of this recommendation would authorize the development of an RFP and conducting of an RFP process for the vacant first floor space at the 4th Street end of the City Hall Wing. The successful proposer would be selected based on the offered financial terms, identified uses and risks to the City. The RFP would be expanded to allow non-food uses.

Staff anticipates completion of the RFP process in eight months. Following the evaluation of RFP responses, Staff would return to Council with a recommendation on next steps.

ANALYSIS

The following analysis section includes: 1) a brief summary of some key factors influencing the RFP process: the current retail market, the cost of improvements and the City's labor peace provision and 2) an overview of the survey of stakeholders and the implications of the comments received.

Current Retail Market

Overall, San Jose is a healthy retail market with among the nation's lowest vacancy rates (3% at malls) and highest average rents ($2.75 per square foot per month). The downtown retail vacancy rate, however, is higher (14%). At the same time, the retail climate has cooled over the past year with tenants able to extract concessions from even established retail centers. Further, the credit markets continue to experience difficulties despite recent congressional action.

Cost of Improvements

From the initiation of the planning for the new City Hall, retail uses were envisioned for the roughly 6,200 square feet at the west end of City Hall. To maximize the City's flexibility, final improvements to the space were deferred, allowing both the number of tenants (one to three reasonably) and the types of uses (restaurant, retail, commercial, etc.) to vary based on City Hall's final needs and the dictates of the market.

The most recent RFP issued by the Agency included a Council approved City General Fund investment of $800,000, an amount which Staff does not propose to increase. The total estimated improvements at that point for most uses were between $1.6 and $1.8 million.

Staff expects that the nature of the tenant improvements would be part of the negotiation with the successful proposer with the objective of maintaining the long-term utility of the space.

Based on the significant up-front investment required to use the space, Staff anticipates that any respondent will attempt to recover the costs through lower operating costs (i.e.: lower lease rate) over a longer lease term.

Labor Peace Provision

The inclusion of a labor peace provision in City contracts is based on considerations including but not limited to the following factors:

- Whether the service or labor is provided on a City site or a site that is important to the proprietary interests of the City;
- Whether the service provider relied on a significant amount of public patronage;
- The economic effect of any disruption of City expenditures or revenues is significant; and
- The effect of any disruption on the citizens, tourists and businesses in the community is significant.

For those instances where vulnerability exists, proposers are required to include how they will take adequate steps to prevent labor disputes or unrest from occurring during the term of the City contract. Proposers are free to submit any plan or program which they currently implement or which they propose to implement which demonstrate a good working environment and adequate plans or programs to prevent disruption in services due to disputes with their employees.

Examples of City facilities with existing labor peace provisions include the Airport and Convention Center.

The most recent RFP provided possible examples of labor peace plans or programs ranging from "A written dispute resolution policy or procedure" to "Labor neutrality provisions - ...the proposer...will accept a union's campaign to convince...employees about the merits of unionization and also refrain from offering arguments against unionization." The proposers were free to submit other plans or programs for maintaining labor peace.

Survey Overview

As directed, Staff conducted interviews of various stakeholder groups to get their opinions about the types of uses that should be considered for occupancy of the City's retail space, the impact of the cost of improvements and the implications of the incorporation of the labor peace provision. The cost and labor peace provisions had been identified by brokers and developers in the course of the first two RFPs as possible limitations to participation by potential tenants.

The Council identified stakeholder groups were contacted and invited to participate through interviews or focus groups. Approximately 40 stakeholder representatives chose to participate.

In the course of the survey, three organizations expressed a desire to participate in a future RFP if the City were to issue one: Sonoma Chicken Coop, Team San Jose/Centerplate Corporation and SSP (formerly Creative Host).

Implications of Survey

There is **sufficient interest** in the City's retail space to warrant issuing a new RFP. Three organizations of the 40 contacted indicated that they would respond in the event that the City chose to issue a new RFP.

Non-food uses should be pursued. Many of the survey respondents thought that other types of uses could effectively make use of the retail space.

The City should anticipate leases which are **below market rents**. The combination of the high costs of the remaining tenant improvements and the perception that the labor peace provision will entail great complexity are likely to make the space less attractive relative to other opportunities Downtown. If the RFP is issued, Staff will work with potential proposers to identify cost savings and reduce concerns about the labor peace provision.

Proposals are likely to be from **larger companies** because of the requirements for initial investment. Staff can work to encourage smaller business participation through allowing for partnership applications and by reducing any ambiguity in the costs of improvements. The City does have an interest in working with a single developer to avoid the complexity of working with multiple uncoordinated subcontractors in a space that connects directly to critical City Hall systems. Furthermore, the developer will provide a level of stability as individual subtenants vary over time.

For a more detailed summary of the survey, please see Appendix A.

BACKGROUND

In June 2005 Council directed that the City enter into negotiations with Imwalle Properties who had responded to the City's April 2005 RFP to fill the roughly 6,200 square feet of space assigned to retail uses at the west end of City Hall. The City offered $300,000 in General Fund

support for improvements to the space. Ultimately, Imwalle Properties withdrew without reaching a successful conclusion to the negotiations.

In November 2006, the Redevelopment Agency released a second RFP which offered $800,000 in General Fund support toward total estimated improvements of between $1.6 and $1.8 million necessary for occupation of the space. Later, the sole bid was deemed to be unresponsive.

Through the course of the first two RFPs, two issues were identified that impact the ability to lease the space: the high capital investment cost of improving the space (which is a cold shell with limited utilities) and the labor peace provision (which protects the City from potential actions by employees of tenants).

On October 30, 2007 Council declined a recommendation that the ground-floor vacant space be allocated to Staff offices and directed that Staff:

1) Conduct a series of interviews to assess how or if a Request for Proposal (RFP) may be fashioned for the use of the City Hall retail space and that those interviews should include potential bidders on any future RFP

2) This process should include a series of meetings, rather than a single focus group, in particular where potential bidders are involved and that the conversations may be limited to the interviewee alone to ensure that the participants are forthcoming and not reluctant to provide information that might otherwise be available to potential competitors

3) If there are such interviews with a potential bidder that those conversations be based on a publicly available set of questions that will be uniformly posed to all interviewees

4) Stakeholder groups be consulted (such as City employees, labor, community leaders and commercial brokers)

5) Potential commercial uses should include uses other than restaurants, i.e. gymnasiums or other services likely to be utilized by City employees and nearby residents

6) Staff return to Council with recommendations to allow Council to determine whether or not to direct Staff to prepare an RFP.

7) In the meantime, short term uses should continue to be explored.

Based on this direction, letters were sent beginning mid-May, 2008 to the list of stakeholders identified in Appendix B with a list of interview questions (Appendix C). Staff from the Office of Economic Development and General Services conducted focus groups and interviews with the Council identified stakeholder groups.

EVALUATION AND FOLLOW-UP

There are no performance measures directly impacted by this recommendation. Staff will return to Council for authorization to negotiate and execute an agreement with the successful proposer.

POLICY ALTERNATIVES

Alternative 1: Fill Retail Space with City Uses (Office and/or Meeting Rooms)
Pros: It may be possible to create savings for the General Fund by moving City employees from leased spaces to City Hall. In addition, in some cases the relocation would result in greater efficiencies by having those employees closer to their customers or colleagues.
Cons: The City's Downtown ground-floor zoning ordinance restricts office uses in the portion of City Hall in question (Council is scheduled to hear Staff liberalization recommendations on November 18). The cost of improvements (design and construction) to allow City uses is roughly $1.6 to $1.8 million.
Reason for not recommending: This alternative proposal would involve a significant expenditure beyond the previous Council commitment of $800,000 in General Funds and would not produce any offsetting lease revenue in the future though there would be some limited cost savings.

Alternative 2: Issue an RFP Anticipating Payment for Basic Improvements
Pros: Providing the space to the retail community in an effectively industry standard "vanilla shell" would be more likely to attract wider interest resulting in better lease terms. Filling this space with retail is consistent with Council policies to encourage the growth of Downtown.
Cons: The anticipated cost of improvements (design and construction) is roughly $1.6 to $1.8 million in General Fund expenditures rather than the level of funding previously approved by Council ($800,000).
Reason for not recommending: This alternative proposal would likely provide better long-term revenues for the City but could require more than doubling the expenditures that Council has previously approved.

Alternative 3: Continue Temporary Art Display Use
Pros: This would permit the City to defer improvements to a future time allowing the use of the earmarked money for other purposes. The retail condition in Downtown San Jose will improve as the national and regional economies recover resulting in the potential for better tenants at better lease terms in the future. At the same time, the City is able to introduce pedestrians to a variety of new art works.
Cons: The absence of tenants along the western frontage of City Hall creates a gap (albeit, tempered by art) in the pedestrian experience. The space would not be contributing to the payment of the City's debt service for the construction of City Hall.
Reason for not recommending: While this alternative proposal would result in short-term improvements for General Fund budget it does nothing to address the City's long-term issues. In addition, leaving a large gap in the street front is inconsistent with Council policies to encourage the growth of Downtown. It should be noted, however, that if Council approves the staff

recommendation to proceed with a new RFP, the City Windows art display will continue to be programmed until build-out of the space is ready to proceed.

PUBLIC OUTREACH/INTEREST

- ☐ **Criterion 1**: Requires Council action on the use of public funds equal to $1 million or greater.
  (Required: Website Posting)
- ☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- ☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

While this memo does not meet any of these criteria, this memorandum will be posted on the City's website for the December 2, 2008 Council Agenda. Through the course of the survey, a variety of stakeholder groups were contacted to solicit their opinions. Should Council approve the proposal, the RFP will be distributed widely to potential proposers.

COORDINATION

This memorandum was coordinated with the General Services Department, the Planning, Building and Code Enforcement Department, and the City Manager's Budget Office.

FISCAL/POLICY ALIGNMENT

The release of a new RFP is supportive of the 13th initiative of the City Economic Development Strategy: "Develop Retail to Full Potential, Maximizing Revenue Impact and Neighborhood Livability."

This recommendation supports the Mayor's directive to eliminate the City's structural budget deficit by providing ongoing savings and revenue to the General Fund.

COST SUMMARY/IMPLICATIONS

This memorandum recommends the issuance of an RFP to identify commercial and retail tenants for the vacant space on the ground floor of City Hall on 4th Street (City Hall Retail Space). As part of the 2008-2009 Adopted Operating Budget, $800,000 was allocated for improvements. Staff is not recommending that additional monies be allocated for this purpose.

BUDGET REFERENCE

The table below identifies the fund and appropriation proposed to fund the possible improvements at the City Hall Retail Space.

Fund #	Appn #	Appn. Name		Total Appn	2008-2009 Adopted Operating Budget (Page)	Last Budget Action (Date, Ord. No.)
Current Funding Available						
001	3444	City Hall Retail Space		$800,000	IX - 10	N/A
Total Current Funding Available						

CEQA

Not a project.

PAUL KRUTKO
Chief Development Officer

PETER JENSEN
Director, General Services

For questions, please contact Dhez Woodworth, Economic Development Officer, at 535-8230.

Appendix A

Summary of Survey Results

This summary is grouped into comments on 1) the types of uses recommended, 2) the importance of the costs of improvements and 3) the inclusion of a labor peace provision. For perspective, within each grouping the observations reflect the stakeholder group from which they came.

Identified Uses
The majority of those surveyed felt that food uses were the most compatible with the space and that the City should permit related alcohol consumption. Most brokers and developers felt that the City should anticipate activation of the space only during City Hall hours though a sizable minority felt seven day and longer operating hours would be useful for tenants. Many of those surveyed felt that the City should recognize that higher-end restaurants would expect to sell alcohol as part of their business.

Of the non-food uses, many respondents suggested professional office space or a retail destination with sufficient strength to draw its own clients. City Staff were also strongly supportive of some type of health and fitness option or additional public meeting spaces.

Cost of Improvements
The high cost of improvements necessary is likely to be a barrier to potential tenants according to the developer and broker communities. These groups anticipate that: 1) small businesses would not be able to finance the project (particularly in this market) and 2) sub-market lease rates with long terms would be needed by tenants to allow for recovery of the initial costs of investment. With fully funded improvements, market rates were estimated at between $2.25 and $3.00.

The retail and food service contractor respondents with few exceptions felt that the space would need to be improved at City cost in order for them to be interested.

The trade off between the initial investment required and the lease rates and length of the term was acknowledged by union representatives who generally felt that the cost could be shared between the tenant and the City.

The community leader and staff respondents were more interested in getting the space filled and felt that the City should do what it could to provide a built out space to speed occupancy.

Labor Peace Provision
The retail broker and developer community had the perception that any labor peace provision would hamper the City's ability to secure tenants and that the lease rates achieved would be below market rate with such a requirement. Retail and food contractor respondents echoed this opinion less strongly. These observations were largely based on the understanding that, unlike the Airport for instance, customer interest in Downtown is not so high nor vacancy rates so low as to allow the City space to command the attention to offset the perceptions of complexity associated with the provision.

Union representatives generally felt that inclusion of a labor peace provision would have no significant impact on the actual operations of businesses. Their observation was that opposition to its incorporation was largely based on unfamiliarity or was a negotiating tactic.

Community and Staff commentators placed a greater priority on the occupation of the space and suggested a reduced emphasis on the labor peace provision.

Appendix B

Survey Targets

Brokers

Rick Anderson	Western	Participated
Maggie Bludau	Ritchie Commercial	Participated
David J Buchholz	Colliers International	Participated
Sharon Carmichael	Terranomics Retail Services	Declined
John Kovaleski	Colliers International	Participated
John Machado	Colliers International	Participated
Randol Mackley	Retail Real Estate Group	Participated
Sean O'Carroll	Cornish & Carey	Participated
Jim Randolph	Cornish & Carey Oncor International	Participated
Mark Ritchie	Ritchie Commercial	Participated
Jon Stansbury	Terranomics Retail Services	Declined
Geri Wong	Ritchie Commercial	Participated

Developers

Jack Bariteau	Keenan & Bariteau	Participated
Seth Bland	Wilson Meany Sullivan	Participated
Daniel R. Gray	Gray & Reynolds Properties, Inc.	Participated
Jerry Hunt	Blake Hunt Ventures	Participated
Barry Swenson	Barry Swenson Builder	Participated

Food Service Contractor

David Andrasko	Sodexho US	Declined
Patrick Banducci	HMS Host	Participated
Dan Fenton	San Jose Convention and Visitors Bureau	Participated
Judith J. Jacobs	Urban Concession Managers	Declined
Roddy McOwan	Creative Host Services	Declined
Louis Tuite	Guckenheimer	Participated
William Williams	Food Buy Supply	Declined

Retailer

Victor Alvarez	Andale Mexican Restaurant	Declined
Ernest Klinger	It's A Grind Coffee House	Declined
Skip Braatz	Braatz Enterprises, Inc.	Declined
Dan Brunello	Le Boulanger	Participated
Holland Burton	Atlanta Bread Company	Declined
Peter Cohen	EuroCoffee/Eurotal	Participated
Hassan Houmani	Murphy's Deli	Declined
Ellia Karres	Panera Bread	Declined
Charles Kaufman	Bread & Cie	Declined
Billy Lim	Donut Basket	Declined
Kazuyo Matsumoto	Kazoo Japanese Restaurant	Participated
Ray Montalvo	Le Boulanger	Declined
Christina Olvera	Boulevard Coffee	Declined

Owner	Chez Croissant	Declined
Regional Manager	24 Hr Fitness	Declined
Richard Reed	US Fitness Pros	Declined
Jeff Starbeck	Sonoma Chicken	Participated
Stanka Vukovich	Caffe Adria	Declined

Unions

Bob Brownstein	Working Partnerships	Participated
Phaedra Ellis-Lamkins	South Bay Labor Council	Participated
Enrique Fernandez	UNITE HERE	Declined
Mike Garcia	Service Employees International Union	Declined
Ron Lind	United Food & Commercial Workers Union	Participated
Neil Struthers	Santa Clara/San Benito Building Trades Council	Participated

Appendix C

Interview Questions for City Hall Retail Meetings

- What uses do you envision for the space? Potential uses that have been mentioned include: food and beverage, health and fitness, services such as real estate or architectural firms, other retail uses, and City uses such as the City's Office of Cultural Affairs or for meeting space that could be used for public meetings as well as City training. Please give us your thoughts about these potential uses or any other uses you would suggest.
  - If a food establishment is one of the uses, should it be permitted to serve beer and wine?
  - How many days of the week and what hours of operation do you consider acceptable for whatever uses are placed in this location?

- In previous RFP's for this space, the City required that the final agreement with a master tenant include a Labor Peace provision (as defined in the attached document). If a new RFP is issued, would you advise the City to:

  a. Make no changes to the Labor Peace provision

  b. Make changes to the provision so that it remains in the document in a different form

  c. Remove the provision

  What reasons do you have for the choice you've recommended? What impact do you expect your choice would have on a new RFP, and/or potential interest in making a proposal?

- The City's current estimate for the cost of improvements to the City hall retail space to make it workable for potential tenants is $1.65-$1.9 million, depending on the use. The City Council has committed to providing $800,000 toward this cost.

  The remainder could be covered:

  a. entirely by potential tenants and/or a master tenant

  b. covered entirely by the City

  c. shared in some proportion between the tenants and the City.

  In each case, the City has standards for the condition of the space that it would require. Which of these options would you recommend? What impact would the options have on a new RFP, and/or potential interest in making a proposal?

- If the City decides to issue a new RFP, it would reflect decisions about the two questions above. Based on your recommendations, regarding those two questions, what lease rate and terms (including renewal provisions) would you suggest that the City could expect to negotiate with a potential master tenant or individual tenants?