TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: SEPTEMBER 13, 2004 CMR: 411:04

SUBJECT: AWARD OF OPTION TO LEASE TO JSRFIT, L.L.C., D.B.A. FORM FITNESS HEALTH CENTER AT LOT S/L SITE NON-PARKING AREA, 445 BRYANT STREET

RECOMMENDATION
Staff recommends that Council authorize the Mayor to execute the attached option to lease with JSRFIT, L.L.C., d.b.a. Form Fitness Health Center, for a 7,410 square foot space in the non-parking portion of the Lot S/L site, 445 Bryant Street.

BACKGROUND
On March 19, 2001, Council approved a new University Avenue Off-Street Parking Assessment District to provide funding to design and build two new parking structures on Lots R (High/Alma South Garage) and S/L (Bryant/Florence Garage). In addition to building a parking structure on the Lot S/L site, Council approved construction of a non-parking area that would be an extension of the parking garage. Costs for building the non-parking extension were to be paid from Certificates of Participation (COP) backed by the City’s General Fund. Initial plans for this area were for a downtown teen center, with the remaining space to be used for rental and other commercial purposes. Rent from commercial users was to be used to offset the City’s debt service costs for constructing the non-parking area.

On May 14, 2001, as a result of receipt of the Youth Master Plan study and a student survey indicating teens would prefer having more programs, activities and special events to a new downtown teen center, Council approved a staff proposal endorsed by the Youth Council to allocate 75 percent of net revenues derived from renting the entire non-parking area to funding youth and teen activities. Council also approved a Barker Hotel parking assessment subsidy. On December 10 and December 17, 2001, Council reviewed and approved the financing for construction of the non-parking area on the Lot S/L site. Construction of the non-parking area was completed in February 2004, and staff began advertising the space for lease in early April 2004. Proposals were received until June 9,
2004, by which time six written proposals were submitted. In accordance with Policy and Procedures Policy 1-11 (Leased Use of City Land/Facilities), notices of a public hearing before the Council to consider awarding an option to lease were published in local newspapers and mailed to tenants and property owners within 300 feet of the property. On July 19, 2004, the Council held the public hearing and considered the staff recommendation to grant an option to lease for a restaurant use for the property (CMR:350:04). Council rejected staff’s recommendation and directed staff to return with an option to lease for the Form Fitness Health Center (Form Fitness).

DISCUSSION
The non-parking area space for lease totals 7,410 square feet, consisting of two 3,705 foot floors of open bare space ready for a tenant to build to suit. The zoning allows for ground floor retail and second floor office or retail. During the design process, Council specified the uses that would be permitted under the Ground Floor Combining District (GF) which were: 1) eating and drinking; 2) personal services; 3) retail services; and 4) travel agencies.

As discussed in the May 10, 2004 City Manager’s Report to Council (CMR:253:04), the non-parking area of the Lot S/L garage was constructed for less than the budgeted cost, leaving $1 million remaining in bond proceeds. Some of these remaining funds will be used to pay for shell improvements, such as the heating and air-conditioning system (HVAC) and sprinkler system, in order to assure the equipment installed will be dependable and the easiest for the City to maintain. The City will be responsible for maintaining the outside of the building, the roof, the HVAC, sprinkler system and elevator. The tenant will be responsible for all other maintenance, taxes, assessments, and insurance.

Form Fitness Proposal
Form Fitness proposes a 10-year lease for the entire 7,410 square feet of space, with a $10 per square foot City allowance for improvements and an initial rent of $1.85 per square foot, increasing to $3.95 by the 10th year, resulting in a total income to the City of $2,803,203 over the 10-year term. By the 7th year of the lease term, the rent will be $3.75 per square foot, enough to cover the annual debt service payment for the COPs. Attachment A shows the proposed rent for each year of the lease, the total projected lease income and the total contribution to tenant improvements.

As described in its proposal, Form Fitness would like to occupy the property for a full service health and fitness center. The ground floor will include a reception area; a pro-shop selling workout related products; showers; lockers; one group exercise room for classes such as indoor cycling, aerobics, and yoga; and an area for providing child care while parents work out. The second floor facing Bryant will be dedicated to a second group exercise room with cardio machines such as treadmills and stair masters. The
second floor facing Lytton will include a weight room plus additional rest rooms and an office. In partnership with the Albert L. Schultz Jewish Community Center (JCC), Form Fitness will offer group classes including kickboxing, circuit training, indoor cycling, yoga and dance. It will also provide programs for school age children such as kids’ kickboxing, self-defense, bike safety, “Mommy and Me” classes and a cycling team for young teenagers. Additional details of its program, including other public service benefits to be provided by Form Fitness are described in its attached proposal (Attachment A). Among these are discounts and special programs for teens and seniors; youth and senior outreach programs in partnership with the Palo Alto Recreation Department and Avenidas; creating a partnership with Palo Alto Community Child Care (PACCC) so that Form Fitness members may utilize the services offered by PACCC; supporting the fitness needs of the Jewish Community Center and its members; in partnership with the Community Breast Health Project, providing nutritional and healthy lifestyle seminars for cancer patients and post treatment survivors; and holding an annual fundraising event with the proceeds going towards teen programs in the City.

Form Fitness has been operating at another location in downtown Palo Alto since January 2003. It currently has 9 employees and 450 members. Form Fitness has provided financial statements for the current operation. The business shows operating losses for both 2003 and 2004; however, as the business has grown, the losses for 2004 are significantly less than for in 2003. Form Fitness has recently formed a Limited Liability Company (LLC) consisting of three people, including the founder and manager of the current Form Fitness operation. All three have executive experience in business and two have significant experience in the management and operation of fitness centers. The five-year pro-forma for the proposed operation shows operating losses for the first 2 years of operations; however, the LLC has provided staff with evidence of sufficient financial security to cover the entire amount projected to be needed for the first 5 years of operations. During the option period and prior to execution of the lease, Form Fitness will be required to provide evidence of sufficient financial security to complete its share of the tenant improvements.

Total tenant improvements and equipment costs for Form Fitness are estimated at $800,000. The City will contribute up to $10 per square foot ($74,100) for items such as the HVAC, sprinkler system, grease trap, electrical upgrade and ADA compliant restrooms. In addition, the City will pay $15,000 to $20,000 to seal a stairwell opening in the second floor. Form Fitness will be responsible for all costs above $10 per square foot.

Option to Lease
Staff has negotiated the attached option to lease with Form Fitness. Terms of the option and lease are summarized in Attachment B. Under the option agreement (Attachment C), Form Fitness is granted a nine-month period to satisfy the specified conditions prior to
exercising the option and entering into the lease. The major conditions the optionee must satisfy:

1. Pay the option purchase price ($5,000).
2. Receive approval of its improvement plans from the Architectural Review Board and receive approvals from the City Engineer and Chief Building Official of the construction drawings, including the construction contract form and proposed construction schedule.
3. Receive approval of any and all permits required to implement the proposed use and improvements.
4. Satisfy the Director of Administrative Services that optionee has sufficient finances or financial commitments to implement the project as approved by the City and furnish the Director of Administrative Services with evidence that sufficient financial security will be available to construct the project.
5. Submit to the Real Property Manager a security deposit as required by the Lease.

Once the option conditions are met, the lease will be executed by both parties without returning to Council. The 10-year term of the lease will begin upon execution of the lease; however, payment of rent will not begin until construction of tenant improvements is completed and the occupancy permit is issued, which is estimated to be three months from execution of the lease. Prior to construction, the tenant must provide satisfactory evidence, such as a completion bond or performance bond, assuring that sufficient funds will be available to complete the approved construction. All improvements will become the property of the City upon termination of the lease. Should the tenant exercise its option to extend the term of the lease, market rent for the new term will be determined by agreement between the City and tenant or, if agreement cannot be reached, through the appointment of a mutually acceptable broker to establish the new rental value. In no event will the new adjusted market rent be less than the rent paid for the previous year, and any increase is subject to a maximum of 10 percent.

**RESOURCE IMPACT**
The City’s cost for structural improvements will be $74,100, plus $15,000 to $20,000 to seal a stairwell opening in the second floor, to be paid from the $1 million remaining in bond proceeds from the construction of the non-parking area of the Lot S/L garage. Staff is in the process of evaluating whether to use remaining COP proceeds to retire certificates or offset annual debt service.

Total rental income to the City over the 10-year term of the proposed lease will be $2,803,203. For the first six years of the lease, the rental income will be used to partially offset the $320,000 annual debt service payment on the taxable COPs used to construct the non-parking space on Lot S/L. Starting with the seventh year of the lease, the rental income will be adequate to pay the COP annual debt service, with any excess rental
income to be used to partially offset the Barker Hotel parking assessment; and, for youth and teen services.

**POLICY IMPLICATIONS**
The proposed option to lease does not represent any changes to existing City policy.

**ENVIRONMENTAL REVIEW**
An Environmental Impact Report for the parking structures, including the non-parking area, was prepared as part of the zoning application and was certified by Council on December 20, 2000, by adoption of Resolution No. 7917. During the option period, the optionee will be required to fully comply with all provisions of CEQA as they may apply to improvement plans.

**ATTACHMENTS**
Attachment A: Form Fitness Proposal
Attachment B: Summary of Option to Lease
Attachment C: Option and Lease

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