



M E M O R A N D U M

Date: February 23, 2012

To: California State Lottery Commission

From: Robert T. O'Neill
Director

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Subject: Item 9(a) – San Diego District Office Lease Extension and
Amendment Ratification

ISSUE

Should the California State Lottery Commission (Commission) ratify a lease extension and amendment for the San Diego District Office (SDDO) with Schonlaw Property Management (SPM) that was approved by Acting Director Linh Nguyen on December 6, 2011?

RECOMMENDATION

Staff recommends that the Commission ratify the seven-year lease extension for the SDDO.

BACKGROUND

The California State Lottery (Lottery) leases an approximate 6574 square foot industrial space known as the SDDO and has occupied the facility located at 5656 Ruffin Road, San Diego, California, since June 23, 1987.

The original lease was due to expire February 28, 2012. During the time of negotiations between the Lottery and SPM, a potential buyer made an offer to purchase the property adjacent to the Lottery's space and also owned by SPM. This offer also contained an offer on the building the Lottery currently occupies. During negotiations, SPM explained to the buyer that the lease extension would be presented at the December 8th Lottery Commission meeting.

Because the December Commission meeting was canceled and a change of ownership of the building was in progress that could possibly occur prior to the next Commission meeting, the negotiated extension was in jeopardy. If the lease

extension was not finalized before the sale of the property, it would have left an open lease and placed the Lottery in a vulnerable position. The new building owner was not obligated to accept the rent reduction that was negotiated with SPM and could have reopened the lease extension and amendment negotiations. If this were the case, the Lottery could have faced an increase in rent or notification to vacate that would result in a period of lost productivity and cost the Lottery up to \$1 million in relocation costs.

The California Lottery Omnibus Regulations (section quoted below) grants authority to the Lottery Director to execute lease amendments and extensions in specified circumstances:

III. OPERATIONAL REGULATIONS

E. Competitive Bidding.

13. Leasing Premises for Lottery Business

c. Prior to entering any lease or amending an existing lease, the Director shall obtain the consent of the Commission if the cost is \$250,000 or more. In the event a lease or lease amendment must be accepted and executed prior to the next scheduled Commission meeting in order to preserve favorable terms or due to business necessity, the Director may proceed to finalize the lease or lease amendment with the consent of the Chairman of the Commission. In such an event, the Director shall report on the leased property and the terms of the lease at the next Commission meeting.

The report shall include a description of the property search, the term of the lease, the rates negotiated for the leased space, and any other factors that were considered in determining that lease or least [sic] amendment was favorable and quick action was necessary.

The space continues to be acceptable to Lottery Operations and Sales Divisions and continues to serve the needs of the Lottery as a District Office. The Lottery and SPM have experienced a good working relationship in the past, and it is agreeable to all parties that the Lottery continues to occupy the space.

DISCUSSION

Lottery staff negotiated new terms and reduced rates for the SDDO. The old rate was approximately \$2.10 per square foot or \$13,805.40 per month. Lottery staff was able to negotiate a \$0.45 rate decrease, bringing the cost to approximately \$1.65 per square foot or \$10,847.10 per month for the first year with 2% annual increases for

the term of the lease. The Lottery was also able to negotiate a longer term lease covering the next seven years.

The lease extension total cost is approximately \$967,685.42 for this term. Additionally, the Lottery maintains the right to terminate the lease after the first 24 months of the term with a written 180-day notice to vacate.

SPM agreed to amend the lease to include tenant improvements such as improved lighting in the front office, repair of the wainscot in the restrooms, relocation of the ADA parking spaces and modification of the wheelchair ramp to meet Department of Justice ADA and ABA Guidelines, and install lighting for the flagpole to meet guidelines for U.S. flag etiquette. This work is in progress.

To ensure the Lottery pays market rates, staff performed a market-rate analysis of the surrounding properties located in the Kearney Mesa area in San Diego (Attachment A). In the San Diego area the equivalent average net lease rate is \$1.58 per square foot with \$0.60 per square foot for added CAM (common area maintenance) charges. The current electricity cost is approximately \$0.17 per square foot. The table below compares the Lottery's old monthly cost for rent with that in the lease extension and the average of six comparable properties in the area.

SDDO (6574 square feet)	Rate (\$/sf)	CAM (\$/sf)	Total monthly rent (\$/sf)	Monthly electric cost	Total monthly cost
Original lease	\$1.50	\$0.60	\$2.10	+ \$1100.56	\$14,905.96
Average market rate	\$1.58	\$0.60	\$2.18	+ \$1100.56	\$15,431.88
Lease extension	\$1.05	\$0.60	\$1.65	Included	\$10,847.10

The rates in the lease extension reflect a significant price reduction. Additionally, SPM agreed to assume the cost of electricity for the space. This made the lease a full-service lease which covers all the operational costs, i.e., taxes, insurance, maintenance, sewer, trash disposal, water service, gas, electricity, landscape, and daily custodial services. Including annual increases, the lease extension saves the Lottery approximately \$360,000.00 for the term of the lease as compared to the original lease.

At this time the Lottery has not determined its long-range strategy for the SDDO. The cost to move operations, including necessary tenant improvements, telecommunications infra-structure, and special security conditions to which the Lottery must adhere, makes it impractical to take advantage of all the market

conditions that might have otherwise been available. Fortunately, Lottery staff was able to negotiate a reduction in rent for the SDDO and include the option of a 180-day notice to vacate after the initial 24 months. This option will give the Lottery the flexibility needed when a plan is in place.

Attachments:

- Attachment A
- December 1, 2011 request to execute lease extension prior to the next scheduled Commission meeting
- December 1, 2011 Executed First Amendment to Lease

ATTACHMENT A

COMPARABLE PROPERTIES

Property Address	Sq. Ft.	Base Rate	CAM Charges	Total Market Rent
9555 Chesapeake	6,568	\$1.65	\$0.60	\$2.25
8328 Clairemont Mesa	8,187	\$1.50	\$0.60	\$2.10
8080 Dagget St.	15,897	\$1.50	\$0.60	\$2.10
5925 Kearny Villa Rd.	6,196	\$1.50	\$0.60	\$2.10
3880 Murphy Canyon Rd.	20,765	\$1.80	\$0.60	\$2.40
5050 Murphy Canyon Rd.	5,928	\$1.55	\$0.60	\$2.15
	Average	\$1.58		

*CAM = Common Area Maintenance (sewer, trash disposal, water service, gas, landscape and building maintenance). Lottery staff contacted property brokers in the San Diego area and found that the typical CAM charges in the area of San Diego to be in the \$0.60 per square foot range. The CAM charges are negotiated with the property owner and would be added to the rate to make up the market rent.

Below are two comparisons that included all the utilities and were comparable to the proposed lease as full service.

4180 Ruffin Rd.	5,302	\$1.75	Full service*	\$1.75
5625 Ruffin Rd.	5,593	\$1.80	Full service*	\$1.80

*Full Service covers all the operational costs, i.e., taxes, insurance, building maintenance, sewer, trash disposal, water service, gas, electricity, landscape, and daily custodial services.