



M E M O R A N D U M

Date: October 28, 2010

To: California State Lottery Commission

From: Joan M. Borucki
Director

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Subject: Item 8(b) - East Bay District Office Lease Extension

ISSUE

Should the California State Lottery Commission (Commission) approve a lease extension with Marsoy Co. (Marsoy) for the East Bay District Office (EBDO) for a seven-year term beginning October 1, 2010 and ending September 30, 2017?

RECOMMENDATION

Staff recommends that the Commission approve the lease extension for the EBDO.

BACKGROUND

The California State Lottery (Lottery) has occupied its current 6,375 square-foot facility located at 2489 Industrial Parkway West, Hayward, California, since November 1, 2000. Although the space is not ideal, it is acceptable to Lottery Operations and Lottery Sales and continues to serve the needs of the Lottery as a District Office. The Lottery and the Lessor, Marsoy, have experienced a good working relationship in the past, and it is agreeable to all parties that the Lottery continues to occupy the space. The existing lease extension is due to expire October 31, 2010. The current rate is approximately \$3.57 per square foot or \$21,634.00 per month with 3.5% annual increases. After lengthy negotiations with Marsoy, Lottery staff has negotiated a \$2.19 per square-foot rate reduction to approximately \$1.38 per square foot or \$8,797.50 per month for the first twelve months. Also, the rate of the annual increases has been reduced

from 3.5% to 2%, which is a reduction of 1.5% every year for the term of the lease. Additionally, the Lottery maintains the right to vacate the space with a 180-day Notice to Vacate anytime during the term without penalty.

Lottery staff has also negotiated additional tenant improvements such as new carpet and painting throughout the space upon the execution of the lease. The lease also covers nearly all the operational costs, i.e., elevator services, sewer, trash disposal, water service, gas, walk-off mats, and daily custodial services. The lease extension total cost will be \$784,125.00 for the term.

Although there is currently space available below the new lease rates, the Lottery staff has negotiated with the Lessor, and the rates do reflect a substantial price reduction. The Lottery has not determined its long-range strategy for the EBDO. The cost to move operations, including necessary tenant improvements, telecommunications infrastructure, and special security conditions to which the Lottery must adhere, makes it impractical to take advantage of all the market conditions that might otherwise be available. Notwithstanding these restraints, Lottery staff has been able to negotiate significant reductions in the lease rates.

DISCUSSION

To ensure the Lottery is still paying reasonable rates, staff performed a market-rate analysis of surrounding comparable properties. The following is an example of rents found in the area:

Property Address	Sq Ft	Rate	*CAM Charges	Sub-total Market Rent
32930 Alvarado-Niles Rd., Union City	10,989	\$1.25	\$0.36	\$1.61
25821 Industrial Blvd., Hayward	10,387	\$0.59	\$0.18	\$0.77
26255 Eden Landing Rd., Hayward	7,902	\$1.25	\$0.50	\$1.75
47987 Fremont Blvd., Fremont	8,800	\$0.80	\$0.24	\$1.04
3556 Investment Blvd., Hayward	13,473	\$0.68	\$0.19	\$0.87

*CAM = Common Area Maintenance (sewer, trash disposal, water service, gas, electricity, and daily custodial services). Lottery staff contacted property brokers in the Hayward area and found that the typical CAM charges in the area of Hayward to be in the \$0.18 to \$0.50 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.

While the Lottery's negotiated rent of \$1.38 includes CAM charges and is lower than the current rent being paid, it is still higher than some market rent currently available in the area. The issue is that through the RENEW Project, the Lottery is determining its long-range strategy for the EBDO location and all other Lottery sales locations. Until that work is done it would not be fiscally prudent to relocate the EBDO because of the high cost associated with changing locations. For example, the cost to move the Sacramento District Office was approximately \$1.1 million, which included tenant improvement plans, permits and construction costs, as well as furniture, signage, warehouse racking, telecommunications, and security. The following table summarizes the scenario of staying in the same location at the negotiated rent vs. moving to a new location at the lowest monthly rent that is possibly available. You can see that when the move cost is considered the new location becomes much more expensive for the Lottery.

	Square Feet	Market Rate per Square Foot	Monthly Rent	Monthly Move Cost When Spread Over the 7-Year Term of the Lease	Total Monthly Cost to Lottery Over the 7-Year Term of the Lease
Same Location	6,375	\$1.38	\$8,797.50	\$0	\$8,797.50
New Location	6,375	\$0.77	\$4,908.75	\$13,095	\$18,003.75

Unfortunately, until the long-range strategy is defined, it makes the most sense to keep the District Offices where they are, even at slightly higher rates than are available in the area. Fortunately, Lottery staff was able to negotiate a reduction in rent for the EBDO and included in the new lease terms the option of a 180-day Notice to Vacate anytime during the term without penalty. This option will give us the flexibility needed when a plan is in place.