



M E M O R A N D U M

Date: April 14, 2011

To: California State Lottery Commission

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Subject: Item 8(a) - South San Francisco District Office Lease Extension

ISSUE

Should the California State Lottery Commission (Commission) approve a lease extension and amendment for the South San Francisco District Office (SFDO) with LBA Realty Fund II – WBP II, LLC (LBA) for the term from July 1, 2011 through June 30, 2018?

RECOMMENDATION

Staff recommends that the Commission approve the lease extension for the South San Francisco District Office.

BACKGROUND

The California State Lottery (Lottery) leases an industrial space known as the South San Francisco District Office and has occupied the current approximately 6,293 square-foot facility located at 815 and 820 Dubuque, South San Francisco, California, since July 18, 2003. The space is acceptable to the Lottery Operations and Sales Divisions and continues to serve the needs of the Lottery as a District Office. The existing lease extension is due to expire June 30, 2011. Lottery staff has negotiated new terms and reduced rates for the SFDO. The current rate is approximately \$2.67 per square foot or

\$16,802 per month. Lottery staff has been able to negotiate a \$0.77 rate decrease bringing the cost to approximately \$1.90 per square foot or \$11,956.70 per month for the first year with .002% annual increases for the term of the lease. The Lottery has also been able to negotiate a longer-term lease covering the next seven years. The lease extension total cost will be approximately \$1,066,673.95 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.

The Lessor LBA has agreed to amend the lease to include tenant improvements such as install new diffusers in the lights to improve the office lighting throughout; restore the HVAC to the warehouse; replace ceiling tiles as needed; clean the carpets; and restore vinyl floors. The Lottery and LBA have experienced a good working relationship in the past, and it is agreeable to all parties that the Lottery continues to occupy the space.

To ensure the Lottery is still paying market rates, staff performed a market-rate analysis of the surrounding properties in the area for comparable rates. All examples of rates listed below are based on triple net* rates. Staff found no full-service properties in the area to compare with the existing lease. The following is an example of rents found in the area which justify the new lease rates:

Property Address	Sq Ft	Rate*	CAM* Charges	Sub-total Market Rent
401 So. Canal Street	24,982sf	\$1.20	NNN	\$1.20+
20 Linden	2,700sf	\$1.00	NNN	\$1.00+
299 Lawrence Ave	20,050sf	\$1.00	NNN	\$1.00+
967 Airport Blvd	2,548sf	\$1.25	NNN	\$1.25+
1352 San Mateo Ave	8,333sf	\$1.10	NNN	\$1.10+
385 Oyster Point	6,983sf	\$1.25	NNN	\$1.25+
405 Victory Ave	7,140sf	\$0.75	NNN	\$0.75+
513 Mayfair Ave	12,000sf	\$0.95	NNN	\$0.95+

*There are numerous forms of net leases. The most common of these is the Triple Net (NNN) lease. In a Triple Net lease, the tenant is responsible for their proportionate share of property taxes, property insurance, common operating expenses common area maintenance (CAM charges) and common area utilities. Tenants are further responsible for all costs associated with their own occupancy including personal property taxes, janitorial services and all utility costs. When these costs are added, the overall costs for comparable properties will be equivalent to or more than what the Lottery will pay.

Although there is currently space available below the market rates, the Lottery has negotiated with the Lessor, and the rates do reflect a price reduction. The current lease is FULL SERVICE which covers nearly all the operational costs, i.e., sewer, trash disposal, water service, gas, electricity, landscape, and daily custodial services.

At this time the Lottery has not determined its long-range strategy for the South San Francisco District Office. 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 otherwise be available. Given these restraints, Lottery staff has been able to negotiate significant reductions in lease rates.