

All state leases back on the table

Extensions offered to landlords in exchange for cheaper rents

Sacramento Business Journal - by [Michael Shaw](#) Staff writer

Sacramento's largest office user has put landlords on notice: Reduce rents and you'll have a good shot at keeping the state of California as a tenant for years.

The Department of General Services, which directs and manages most of the state's real estate requirements, has formed a task force to review every state lease in light of the budget crisis and favorable office market conditions. Department employees have notified landlords and state agencies that it's offering to extend leases if landlords cut deals.

While negotiations are still in the early stages, many landlords are responding favorably. They potentially would collect less income in the short term if they cooperate, but they get the benefit of locking up state agencies for several years, a priority in one of the softest markets in recent history. Office vacancy rates in Sacramento have been rising for two consecutive years, giving tenants the upper hand.

The move is likely to save taxpayers millions of dollars a year, though it won't make a sizable dent in the state's estimated \$24 billion budget shortfall. In the Sacramento region, California agencies account for 7 million square feet of leased office space — about 15 percent of the overall office market in Sacramento County — and another 2 million in storage or other type of leased commercial real estate.

With that kind of presence, California has huge leverage.

State officials were reluctant to talk about potential savings, but some office brokers estimate they could be in the range of 10 percent to 15 percent. California pays \$178 million a year in rent in Sacramento County, the department said.

"We're always looking at getting the best rates in any market," said Patrick Foster, assistant chief of real estate leasing at General Services. "But with the budget situation and the market the way it is, we can see an opportunity."

He said the process is in the early stages, with just a few new leases out for signatures and expects more action within the next two or three months.

“(Landlords) are getting very aggressive,” Foster said of potential discounts. “I’ve never seen the market react like this.”

Previous attempts haven’t been as successful.

“We went through this a few years ago,” said Jim King, an office broker with **CB Richard Ellis** who’s working on a state office deal. “This time, the market seems to be more receptive. From a landlord’s perspective, it makes all kinds of sense.”

King would not discuss the deal he’s working on, but said he expects all but the most recently signed leases to get scrutinized for potential savings. He said it’s hard to say whether this push will lead to a dramatic increase of renewals or a significant shuffling of state agencies among different spaces.

The state’s previous push for better rent rates was less effective because it came during a stronger market, said Nico Coulouras, a vice president with **Lowe Enterprises Real Estate Group**. Coulouras doesn’t have any state tenants, but when he did several years ago he received letters looking to trade extensions for rent breaks, a move also prompted by a budget crisis. Now, he said landlords would be foolish not to discuss it.

“If I did have state tenants, I’d gladly sit down with them,” he said.

John Frisch, managing partner at **Cornish & Carey Commercial**, whose office represents the state in many lease transactions, expects a 10 percent to 15 percent savings in two big leases being renegotiated now. The California Department of Corrections and Rehabilitation occupies about 300,000 square feet at Benvenuti Plaza near 15th and S streets, and the State Controller’s Office occupies several floors at 300 Capitol Mall, also known as the Emerald Tower. Both are looking for a new deal with about three years left on their leases.

Frisch said the “blend and extend deals” are a direct result of the market; typically a lease negotiation would start closer to the expiration date.

“The market is certainly on their side,” he said. “Like any tenant, they’re looking to find the bottom. As a taxpayer, that’s exactly what you want them to be doing.”

State leases are typically eight years with the past four years “soft-term,” meaning the state can end the lease relatively easily during the soft period.

“When we’re in the soft-term or winding down from the firm-term years, we have the ability to give additional firm-term years in exchange for a reduction in rent,” Foster said. “We’re getting a lot of response.”

Getting a better rent rate isn't the only area where the state is looking to cut expenses. Cutbacks and furloughs mean agencies might need less space. That could lead to movement beyond lease renewals and the department is looking to consolidate or reduce the amount of space state agencies use.

"There could be a reduction of force at an agency or a loss of a program," Foster said, noting that the effort hasn't yet resulted in many reductions. "That's more of a strategy right now,"

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The state is looking for a new lease for the Department of Corrections, which occupies about 300,000 square feet between R and S streets at Benvenuti Plaza. The landlord is negotiating with the Department of General Services.

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