Executive Summary

SALE // LEASEBACK State Office Building Portfolio

INTRODUCTION

To address the fiscal emergency declared by the Governor by proclamation on July 1, 2009, the Legislature authorized the Department of General Services (DGS) to sell and lease back 11 state-owned office properties (Chapter 20, Statutes of 2009 (AB 22, Fourth Extraordinary Session, Evans, enacted July 28, 2009). Proceeds from the sale of the properties are to be deposited in the General Fund. Please refer to Attachment A for a listing of the individual properties.

To implement the bill, the DGS conducted a highly competitive process to select a nationally recognized commercial real estate brokerage firm to assist with the marketing of the properties and to evaluate the purchase offers.

DGS selected CB Richard Ellis based upon their team of qualified personnel having experience in providing commercial real estate brokerage and advisory services to sellers of large-scale investment/income properties and sale-leaseback transactions for governmental and/or corporate clients. The DGS also conducted extensive due diligence utilizing internal staff and external third party independent consultants.

Thirty days prior to executing the transaction for the sale and lease of the properties, the Director of DGS must report to the chairs of the legislative fiscal committees the terms and conditions of the transaction, including, but not limited to, the financial terms.

Above: Franchise Tax Board Complex, Sacramento County

Public Utilities Commission Building, San Francisco

DGS, in consultation with CB Richard Ellis, has selected a buyer and is prepared to provide the notice to the legislature. Please see Attachment B for a copy of the official notice.

TRANSACTION SUMMARY

- Sale will generate $2.330 billion in revenue on or before December 31, 2010
- State will redeem and/or defease approximately $1.09 billion in existing lease revenue bonds encumbering the properties which will result in elimination of $118.1 million in 2010-11 annual debt service obligations associated with this secured property debt.
- Sale will generate approximately $1.229 billion in net cash proceeds, after redemption and/or defeasance of the lease-revenue bonds encumbering the properties and subtracting transaction costs.
- State will shed responsibility for most currently-accumulated deferred maintenance, future capital replacement obligations and renovations for these 11 properties.
- State will transfer approximately $58 million in 2010-11 annual property operating expenses to the buyer.

BACKGROUND

Marketing and Request for Offers

A managed bid process was selected to achieve the maximum price and to provide the highest certainty of closure. The process involved successive rounds of offers where prospective buyers conducted, reviewed, reconciled, addressed and/or priced due diligence matters in their succeeding offers.

In order to maximize proceeds and minimize future occupancy costs, buyers were required to price a modified gross lease structure. The State's proposal was to sell and then lease back each property from the buyer(s) for a period of 20 years, with six successive options to renew for a period of five years each. This would allow the State to control the properties for 50 years.

Initial offers were due and received on April 14, 2010, and resulted in individually priced property offers and 30 portfolio offers. Because the most aggressive pricing on the majority of the assets in the first round of offers consisted predominantly of the portfolio buyers, the portfolio buyers were invited to participate in the second round of offers. The second round offers were received on May 11, 2010, and resulted in 16 portfolio offers, of which 11 proposals were in excess of $2 billion. Those exceeding $2 billion were invited to participate in the final round of offers.

The best and final offers were received on May 21, 2010, and qualification interviews were conducted on May 23, 2010. This interview process included: a review of the buyer's financial capabilities; assessment of the terms and conditions in their offer, including due diligence and closing timeframes; and an analysis of the need for debt and past performance. As a result, the buyer pool was reduced to the most qualified buyer that is willing to pay the highest price and that conforms to the terms and conditions offered by the State and who is the most likely to close.

New Junipero Serra State Building, Los Angeles

Highest and Best Offer

DGS is recommending that the State select California First, LLC as the buyer of the properties based upon the terms and conditions of their offer. The key terms and conditions are listed below. A detailed summary of the terms and conditions is contained in the notice to the Legislature, Attachment B.

SALE // Terms and Conditions

- *Buyer*: California First, LLC
- *Purchase Price*: $2.330 billion
- *Financing*: 60% Debt (JP Morgan); 40% Equity (Private)
- *Properties*: Portfolio
- *Earnest Money Deposit*: $55 million
- *Title, Escrow and Closing Costs*: Paid for by buyer
- *Conditions*: All cash at close of escrow
- *Escrow*: Estimated to close on or before December 31, 2010

LEASEBACK // Terms and Conditions

- The State will leaseback the properties for a term of twenty (20) years. The State will have six options to extend the original lease term for an additional five years each.
- The State will pay market rents and will be responsible for the costs of natural gas and electric utility service.
- The buyer will be responsible for the costs of operation and maintenance of the buildings and for all other services and utilities.

Analysis of Sale/Leaseback Costs vs. Status Quo

DGS has prepared a detailed comparative analysis of the costs of the sale/leaseback versus the costs of continued state ownership of these properties. A summary of the economic analysis is contained in the notice to the Legislature.

- The net present value of the cost of the sale/leaseback transaction for the 20-year term is $2.200 billion.
- The net present value of the cost of the status quo for a 20-year period is $2.202 billion.