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ENDORSED
FILED
San Francisco County Superior Court
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IN THE SUPERIOR COURT OF CALIFORNIA

IN AND FOR THE COUNTY OF SAN FRANCISCO

JERRY B. EPSTEIN, individually, and as a taxpayer; and, A. REDMOND DOMS, individually, and as a taxpayer; **Petitioners/ Plaintiffs,** **vs.** **ARNOLD SCHWARZENEGGER, Governor of the State of California, sued in his official capacity; RON DIEDRICH, Acting Director of the Department of General Services, sued in his official capacity; DEPARTMENT OF GENERAL SERVICES; and DOES 1 through 50, inclusive,** **Respondents/Defendants.**	**CASE NO. CGC-10-505436** **VERIFIED** **PETITION FOR WRIT OF MANDATE;** **COMPLAINT FOR INJUNCTIVE AND DECLARATORY RELIEF FOR:** **1. FAILURE TO COMPLY WITH STATE LAW** **2. WASTE OF PUBLIC FUNDS** **3. UNCONSTITUTIONAL GIFT OF PUBLIC GOODS**

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LAW OFFICES
COTCHETT, PITRE, & MCCARTHY

Petitioners/Plaintiffs, **JERRY B. EPSTEIN,** and **A. REDMOND DOMS**, hereby allege as follows:

I. GENERAL ALLEGATIONS

1. This action involves a ***sale of eleven iconic properties owned by the State of California***, to a conglomerate of private investors. The properties at issue house a wide-array of government agencies and courts, including the California Supreme Court and the Courts of Appeal. As stated in the Declaration of **JUSTICE RICHARD D. HUFFMAN**, the "Judicial Council has not authorized the sale or lease-back" of the court facilities and the "Judicial Council has not given its consent for the sale or lease-back" of the court facilities.[1/] Justice Huffman is the **Chair of the Executive and Planning Committee of the Judicial Council**.

2. The sale is the result of a deal reached by the Governor and the Legislature to close a hole in the 2009-2010 state budget. In both the short and long-term, the transaction will cost California's taxpayers billions as the state becomes a tenant in the buildings that it currently owns.

3. The sale represents an unprecedented transfer of taxpayer-owned property to private investors. It is an illegal waste of public funds and unconstitutional transfer of public property to private beneficiaries. Furthermore, in pushing through the sale, the Governor and the Department of General Services ("DGS"), and its Acting Director, Ron Diedrich have ignored the legally-mandated authority of the Judicial Council to act as an owner of the state's appellate court facilities, and the legal authority of the state's regional building authorities to oversee government office buildings.

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1 See Declaration of Justice Richard D. Huffman ("Decl. of Justice Huffman") filed herewith in support of Petition and Complaint.

II. PARTIES

4. Petitioners/Plaintiffs **JERRY B. EPSTEIN and A. REDMOND DOMS** are taxpayers of the State of California and former members of the Los Angeles State Building Authority, and sue herein as private taxpayers.

5. Respondent/Defendant **RON DIEDRICH** ("Diedrich") is the Acting Director of the California Department of General Services and is therefore the head of the Department of General Services ("DGS"). (Gov. Code § 14605)

6. Petitioners/Plaintiffs bring this action against Diedrich in his official capacity.

7. Respondent/Defendant **DEPARTMENT OF GENERAL SERVICES** is a state department with responsibility for certain aspects of construction, alteration, repair, and improvement of state buildings. (Gov. Code § 14600 et seq.)

8. Respondent/Defendant **ARNOLD SCHWARZENEGGER** ("Schwarzenegger") is the Governor of the State of California and a state constitutional officer. (Cal. Const. Art. V, § 2.)

9. Petitioners/Plaintiffs bring this action against Schwarzenegger in his official capacity.

III. VENUE

10. A portion of the real property that is the subject of this action is located in the City and County of San Francisco, making the Superior Court of San Francisco a proper court for trial of this matter (Code Civ. Proc. §392(a)(1)), specifically the real property at the following addresses:

- 350 McAllister Street in the City and County of San Francisco;
- 455 Golden Gate Avenue in the City and County of San Francisco; and,
- 505 Van Ness Avenue in the City and County of San Francisco.

IV. FACTUAL ALLEGATIONS

A. THE SALE OF STATE'S CROWN JEWELS

11. The State of California is deeply in debt – that fact is unmistakable. Yet a little bit of light was on the horizon insofar as numerous large state-owned office buildings are close to paid for.

12. For 30 years, under Democratic and Republican governors, the state has lowered the cost of office space for its courts, employees and agencies by constructing state-owned buildings.

13. Yet, late last summer, with little study and with almost no public discussion, and without any input from the real estate experts who serve on the relevant state building authorities, Governor Arnold Schwarzenegger and the Legislature agreed to sell eleven (11) state office building complexes, including the Ronald Reagan and Junipero Serra[2/] state buildings in downtown Los Angeles, and the Earl Warren Building, the Hiram Johnson Building and the Public Utilities Commission Building in San Francisco.

14. The decision to sell eleven iconic state properties in a sale to a private bidder was part of a last minute deal to close the state's $20 billion budget deficit. Today the final pieces of the sale are moving forward at a time when prices for commercial real estate are in an historic slump.

15. The sale represents the worst kind of economic policy and will haunt future generations for years to come, as two recent reports by the Legislative Analyst's Office ("LAO") have made clear. According to the LAO's most recent analysis, which was released to the public only a few days ago, the total cost of the

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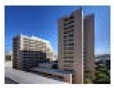
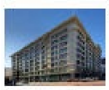
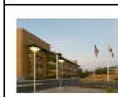
[2] By way of example, before construction of the Ronald Reagan and Junipero Serra buildings, the state was paying more than 75 landlords all across Los Angeles County millions of dollars in rent. The construction of the buildings reduced costs and greatly increased efficiency, since more than 50 state agencies could now be housed just a few blocks apart. The buildings also served as a catalyst for the renaissance of downtown Los Angeles.

sale-leaseback will be approximately $6 billion more than the cost of state ownership over a 35-year period.[3/]

16. Chapter 20, Statutes of 2009 (ABX4 22, Evans), authorizes the DGS to sell and lease back from the new, private owners the following state-owned real property:

BUILDING	*LOCATION*
 Ronald Regan State Building	Los Angeles
 San Francisco Civic Center, also known as the Earl Warren / Hiram Johnson Building	San Francisco
 Public Utilities Commission Building	San Francisco
 Junipero Serra State Building	Los Angeles
 Elihu Harris Building	Oakland
 California Emergency Management Agency Headquarters	Rancho Cordova
 Attorney General Building	Sacramento
 Capital Area East End Complex	Sacramento
 Department of Justice Building	Sacramento
 Franchise Tax Board Complex	Sacramento
 Judge Rattigan Building	Santa Rosa

3 See Exhibit A, Letter from Legislative Analysts Office ("LAO") to Honorable Denise Moreno Ducheny, Chair Joint Legislative Budget Committee, November 5, 2010 (hereinafter "November 5, 2010 LAO Letter").

The legislation grants DGS authority to determine sale and lease terms that are "in the best interests of the state." Gov Code § 14670.13. While the legislation requires the Director of the Department of General Services to report to the chairs of the fiscal committees of the Legislature the terms and conditions of the transaction thirty days prior to executing a transaction for a sale or lease of any of the eleven properties, no further approval of the Legislature is required prior to the sale and lease-back of the properties. Gov Code § 14670.13. The Director of the DGS provided the report of terms and conditions to the Legislature on October 11, 2010. ***The DGS expects the transaction to be completed by December 2010***.

17. Notably, the State Controller, John Chiang, who is the Chief Fiscal Officer of California, has no veto power over this ill-conceived sale. (Gov Code sections 12410-12439.) Nor does the State Treasurer, Bill Lockyer. (Gov Code sections 12320-12333.)

B. THE GOVERNOR AND DGS BYPASSED THE JUDICIAL COUNCIL AND BUILDING AUTHORITIES TO PUSH THROUGH THE SALE

1. The Judicial Council's Statutory Oversight is Ignored

18. Among the government buildings to be auctioned off to the highest bidder are two appellate court facilities. See Decl. of Justice Huffman ¶¶ 6, 7.

a. Sale of the San Francisco Civic Center (Earl Warren & Hiram Johnson Buildings)

19. The Earl Warren Building was built in 1922 and is on the National Register of Historic Places. It heard its first oral argument to the Supreme Court in 1923. It is located at 350 McAllister Street in the North East District of the City and County of San Francisco. After being severely damaged in the Loma Prieta Earthquake, the building was vacated for remodeling and seismic restructuring and reopened in January of 1999. With its reconstructed steel infrastructure and granite and terra cotta facade, this City and National Landmark building now houses the Northern California facilities of the Supreme Court of California as well as the California Courts of Appeal, First District. The Supreme Court's Courtroom was also completely restored with full oak paneling, a 30-foot high skylight and coffered ceilings. Above the bench is a mural of a scenic California landscape painted by Marin County artist Willard Dixon.

20. Built more recently than the Earl Warren building, the Hiram Johnson Building was built in 1999 and is located at 455 Golden Gate Avenue in the City and County of San Francisco. This 14 story high-rise is located directly adjacent and connected to the Earl Warren building in the San Francisco Civic Center Complex. Major tenants of this building include the California Courts of Appeal, the Department of Industrial Relations, several elected officials' offices (including the Governor of California) and the Department of Justice.

b. Sale of the Ronald Reagan State Building

21. The Ronald Reagan State Building is located in downtown Los Angeles at 300 S. Spring Street. The building has 739,000 sq ft of rentable space and is 16 stories high. It houses numerous California state offices including offices of the franchise tax board, the Department of Insurance, and the Attorney

General. The Reagan Building also contains the Supreme Court of California's Los Angeles Branch Offices and Court Room. In addition, the Courts of Appeal, Second District is located in the building.

c. <u>The Judicial Council Enjoys Broad Authority Over Appellate Court Facilities</u>

22. The sale-leaseback may not lawfully proceed without the concurrence of the Judicial Council, which, under Government Code section 69204, has full responsibility, jurisdiction, control and authority over the State's appellate court facilities, including those included in the proposed sale. Decl. of Justice Huffman ¶ 5.

23. Government Code Section 69204 outlines the responsibilities of the Judicial Council and provides as follows:

> **§ 69204. Responsibilities of Judicial Council**
>
> The Judicial Council, as the policymaking body for the judicial branch, shall have the following responsibilities and authorities with regard to appellate court facilities, in addition to any other authority or responsibilities established by law:
>
> (a) Exercise full responsibility, jurisdiction, control, and authority as an owner would have over appellate court facilities, including, but not limited to, the acquisition and development of facilities.
>
> ...

24. The Judicial Council has not been consulted regarding the sale or lease-back of the Earl Warren and Hiram Johnson Buildings and the Ronald Reagan State Building, nor has it given its consent for the sale. See Decl. of Justice Huffman ¶¶ 8, 9.

25. Nothing in the language of ABX4 22 can reasonably be interpreted as amending Government Code section 69204 to divest the Judicial Council of "full responsibility, jurisdiction, control and authority."

26. Following the enactment of SB 1732, adding section 69204 to the Government Code in 2002 and establishing that the Judicial Council had responsibility and authority over appellate court facilities, DGS consistently took the position that the Judicial Council was to assume control of leases from the DGS. In doing so, the DGS cited both SB 1732 ***and the Separation of Powers Doctrine***. For example, in a letter dated June 9, 2006 from DGS to a tenant, Macanan Investments, the DGS states:

> Effective July 1, 2006, the Administrative Office of the Courts and Judicial Council (hereinafter referred to as the "AOC") will replace the Department of General Services (DGS) identified in said lease as the State of California. ***Due principally to the Separation of Powers doctrine between the Executive and Judicial branches of State government***, and also to the recent enactment of SB-1732 in 2003, the DGS has agreed to the AOC's request to assign all current leases from DGS to the AOC. The AOC has a new administrative branch to service leasehold interests.

<u>See</u> Six letters from DGS to Lessors, dated June 9, 2006 and June 26, 2006, attached hereto as <u>Exhibit</u> <u>B</u> (emphasis added); <u>See</u> <u>also</u>, Murphy Decl., ¶ 2.

2. <u>State's Own Real Estate Experts are Kept in The Dark</u>

27. The DGS, its Acting Director Diedrich, and the Governor have gone to great lengths to ***keep the details of the sale secret*** and to prevent scrutiny and consideration of the cost of the sale to the state's taxpayers.

28. Notably, prior to passage of ABX4 22, none of the state government's own expert real estate entities were given an opportunity to provide any substantive input regarding this foolish (and unconstitutional) sale of taxpayer-owned assets.

- The Judicial Council, which has a statutory mandate to stand in the place of an owner of appellate court facilities, was not consulted regarding the sale of the Ronald Reagan State Building and the Earl Warren and Hiram Johnson Buildings. (<u>See</u> Govt. Code § 69204) See Decl. of Justice Huffman, ¶¶ 8, 9.

- The Los Angeles State Building Authority, a three-person body established to plan, finance, and oversee the construction and management of state owned office facilities in downtown Los Angeles was not consulted prior to passage of ABX4 22, despite the fact that the Authority's cooperation is necessary for the execution of the sale of the Reagan and Serra buildings. (See Govt. Code § 6517) See Declaration of Jerry B. Epstein ("Epstein Declaration"), at ¶¶ 3-8; and Declaration of A. Redmond Doms ("Doms Declaration"), at ¶¶ 3-5.
- Upon information and belief, the San Francisco State Building Authority, a three-person body established to plan, finance, and oversee the construction and management of state owned office facilities in San Francisco was not consulted prior to passage of ABX4 22, despite the fact that the Authority's cooperation is necessary for the execution of the sale of the Earl Warren and Hiram Johnson Buildings and the Public Utilities Commission Building. (See Govt. Code § 6517) See Epstein Decl. at ¶ 5; and Doms Decl. at ¶ 5.
- Upon information and belief, the Oakland Building Authority, a three-person body established to plan, finance, and oversee the construction and management of state owned office facilities in Oakland was not consulted prior to passage of ABX4 22, despite the fact that the Authority's cooperation is necessary for the execution of the sale of the Elihu Harris Building in Oakland. (See Govt. Code § 6517)[4/] See Epstein Decl., at ¶ 5; and Doms Decl., at ¶ 5.

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[4] The Oakland State Building Authority planned and directed the construction of the Elihu M. Harris State Office Building, which consolidated the operations of over 40 state departments and agencies throughout the Bay Area. The Elihu M. Harris State Office Building is one of the building complexes slated to be sold to

3. Schwarzenegger Purges the Building Authorities of Possible Dissenters

29. In late February, at the direction of Jerry B. Epstein, who was, at the time, President of the Los Angeles State Building Authority, counsel to the Authority asked the DGS to provide a market study and to clarify the terms proposed by the Schwarzenegger administration. (See Epstein Decl., at ¶ 5, and Exhibit A to Epstein Decl.) The Authority asked for a comparison of the projected net proceeds from the sale and the projected rental and other costs associated with a 20-year lease-back of the same buildings. Id. The Authority's letter to DGS made it clear that the authority has a fiduciary responsibility to the bondholders as well as to the taxpayers of the state, and that no formal decision by the authority would be made until it could hear testimony about the proposed sale, thereby ensuring that the benefits and costs of the proposed transaction had been fully vetted. Id.

30. Three weeks later, Mr. Epstein got a response in a terse two-sentence letter signed by Diedrich: "This is to formally advise you that as of March 17, 2010, I have appointed new members to the governing board of the Los Angeles State Building Authority and decided not to reappoint you. Your prior services have been greatly appreciated." Mr. Epstein was summarily dismissed after serving on the authority for nearly thirty years. See Epstein Decl., at ¶ 7. The DGS refused the Authority's request for information – in fact, it even refused to disclose the location of the escrow. Id. Earlier in March the governor-appointed members of the San Francisco State Building Authority were also summarily dismissed. Upon information and belief, they, too, were skeptical of Schwarzenegger's plan and paid the price. See Richard Epstein, "State Should Keep Ownership of its Buildings," LA Times, April 6, 2010, available online at

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private investors by the end of next month.

http://articles.latimes.com/2010/apr/06/opinion/la-oe-epstein6-2010apr06, last visited November 13, 2010, attached hereto as Exhibit C.

C. LONG STANDING STATE BUILDING AND AWARD PROCEDURES ARE IGNORED

1. Private Real Estate Company CB Richard Ellis Is Awarded Brokerage Contract

31. The legislation exempted DGS from long-standing state bidding and award procedures without specifying any procedures or criteria for DGS to follow in bidding and awarding the sale lease-back. See Exhibit A at 10. As such, DGS had significant discretion in determining the award procedures. Id. The process started with DGS selecting the private real estate company CB Richard Ellis through a competitive bidding process to serve as the broker for marketing and managing the sale-leaseback transaction. Id. Next, DGS worked with CB Richard Ellis to prepare lease terms for the lease-back part of the transaction and determine the bidding and selection process for the buyer. Id.

2. CB Richard Ellis Markets the "Golden State Portfolio"

32. CB Richard Ellis proceeded to market for sale what it aptly named "***THE GOLDEN STATE PORTFOLIO***" which CB Richard Ellis advertised using marketing material showing the Great Seal of the State of California, along with images of state buildings in Los Angeles, San Francisco and Sacramento. CB Richard Ellis touted the Golden State Portfolio as consisting of:

- *11 office properties*
- *7.3 million square feet*
- *20 year sale lease-back portfolio*
- *3 California core metro markets*

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33. Copies of CB Richard Ellis' marketing materials are attached as Exhibit D (CB Richard Ellis Brochure, "Golden State Portfolio," available at http://marketing.cbre.com/Denver/PMC/GoldenState/GSPBRO.pdf, last visited November 13, 2010.). Among CB Richard Ellis' "Investment Highlights" are the following:

- *"The Golden State Portfolio offers investors a truly generational opportunity to acquire a critical mass of functional and well located, primarily Class A office properties, in core submarkets. These assets are in three of California's major metropolitan markets, which are also three of the top thirty metropolitan markets in the United States. Some of the outstanding features of this offering are listed below:"* See Exhibit D at 2.
- *"**Strategic Facilities** – The State of California's commitment to these key facilities is demonstrated by the 20 year lease terms. The state provides the investor a superb captive tenant story based on its*

current utilization of these Class A facilities and the State's projected increased long term space needs. A recent State of California study completed in March 2009 projected an 80% space increase in the next 40 years for the State of California in the Sacramento market alone." See Exhibit D at 2.

- *"**Investment Grade Tenancy** – The 20 year leaseback of the eleven properties by the State of California will enable the investor to enjoy a stable, long-terms income stream from an investment grade tenant. The State of California is rated "A-" by Standard & Poor's and its viability assured as the recognized, most desirable state in the nation."* See Exhibit D at 2.

3. The Bidding Process is Kept Secret and Non-Public

34. Little is known about the bidding process that ensued because of the secrecy surrounding the process. However, upon information and belief, the selection process consisted of multiple bidding rounds. See Exhibit A at 10. ***In deviation from its standard procedures, DGS has not made public any of the details of the non-selected bids***. See Exhibit A at 11. DGS has reported that the initial round resulted in 11 offers exceeding $2 billion, but there is no way to independently confirm this information. The DGS claims to have interviewed these final 11 bidders and invited each to submit a "best and final" offer. Unlike the competitive bidding process for the sale-leaseback broker and the typical awarding of state contracts, ***the sale process did not have any published criteria or scoring system for evaluating the bids***, and the final award announcement did not include a ranking of each qualified bid. According to DGS, however, the final bids were evaluated based on two factors. See Exhibit A at 10-11.

- **Best and Final Price**. According to DGS, the selected bid from California First LLC offered the highest purchase price. (But there is no way to independently confirm this important detail since information about the rejected bids is being kept secret.) See Exhibit A at 10-11.

- **Certainty of Execution**. Due to the size and complexity of the transaction, DGS wanted to ensure that buyers could meet the bid price with minimal risk. The DGS reported that evaluation criteria for this category included the bidders' diligence in reviewing the properties, financial backing, ability to remove contingencies, and ability to close the transaction quickly. (The California First LLC bid relies on 40 percent private equity and 60 percent financing from JP Morgan.) See Exhibit A at 10-11.

35. The DGS' award process was entirely lacking in transparency, making evaluation of the DGS' award of the sale-leaseback purchase difficult. Overall, in contrast to DGS' usual sales and procurement procedures, it appears that the department did not use a specific (objective or subjective) point system for ranking bids based on established criteria. (See Exhibit A at 11.) In addition, it appears that the department does not a have a clear process to allow unsuccessful bidders to file protests. Id. According to information obtained from the Legislative Analyst's Office ("LAO"), when the LAO confronted DGS regarding the unprecedented lack of transparency, the DGS "indicated that the special circumstances relating to this transaction made it difficult for them to follow their usual procedures." Id. Specifically, DGS expressed concern that a selected bidder might withdraw or revise its bid during the 30-day legislative notification period if information about competing bids were to be publicly available. In a report issued November 5, 2010, the LAO makes a number of scathing findings, among them a statement that "[w]hile we acknowledge the potential risks associated with the usual procedures for governmental transparency, we find the paucity of information regarding this major state financial transaction to be troubling." Id.

4. <u>An Investment Conglomerate – California First LLC – is Chosen as the Winning Buyer of all Eleven Properties</u>

36. DGS has announced that it has selected the bid from California First LLC, which offered a purchase price of $2.3 billion for the portfolio of eleven properties. (<u>See</u> <u>Exhibit</u> <u>A</u> at 10.)

37. Although the details are murky, what is known about California First LLC, is that it is a consortium led by Hines Interests and international private equity firm Antarctica Capital Real Estate LLC ("ACRE") (out of Mumbai, India and Chandra Patel), with additional unidentified equity investors. <u>See</u> Department of General Services Press Release "State of California Selects Buyer for State Buildings," October 11, 2010, available at http://www.documents.dgs.ca.gov/dgs/pio/releases/2009-2010/101011.pdf, last visited November 13, 2010., attached hereto as <u>Exhibit</u> <u>E</u>.

38. The secrecy of the process and the dearth of information about the state's new landlords raises serious concerns about the identity of the new owners of these critical government facilities. Among other things, taxpayers have a right to know the identity of the new owners of the buildings housing their courtrooms, tax authorities, and Attorney General's offices.

D. <u>*CALIFORNIA FIRST* STANDS TO MAKE GUARANTEED INCOME AS THE STATE'S NEW LANDLORD</u>

39. The authorizing legislation allowed DGS to determine the lease terms for the lease-back. (<u>See</u> <u>Exhibit</u> <u>A</u> at 3.) In bid materials, DGS requested that all bids conform to a modified gross lease structure with the following components for ten of the properties:

- **Type of Lease**. Under a modified gross lease, the owner would be responsible for paying most building services including building management, janitorial, maintenance, special repairs, insurance, and scheduled upgrades. The owner would pay utilities with the exception of gas and electricity costs, which the state would pay. The state also would continue to provide security at those buildings with unique security needs. (See Exhibit A at 3.)

- **Lease Term**. The initial lease would be for 20 years. After the initial term, the state would have the option to renew the lease under the same lease conditions for six additional terms of five years each resulting in a total lease term of potentially 50 years.[5/] (See Exhibit A at 3.)
- **Annual Rent Payments**. Base rent payments would be set near current market rents for each property. The base rent would increase ***by 10 percent every five years***. (See Exhibit A at 3 (emphasis added).)
- **Operating Cost Escalator**. On top of the base rent payments, the state would be responsible for paying annual changes in the owner's operating expenses. The operating costs would be set at a fixed amount when the buildings are purchased and adjusted each year by the change in the Consumer Price Index to reflect inflation. (See Exhibit A at 3.)
- **Property Tax Credit**. Under the California Constitution, the state is exempt from paying property taxes on the properties it owns. Private landlords renting space to the state, however, generally are charged property taxes based on the assessed value of their properties. The base rent included in the proposed lease assumes that property taxes would be assessed on the properties and that the new owner would make those payments. In the event that the properties remain exempt

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[5] Among other things, this means that the Historic Earl Warren Building, which was built in 1922, and is on the National Register of Historic Places, may become a non-government commercial space by as early as 2030.

from property taxes, the lease terms entitle the state to an annual credit against its rent equal to the amount built in for such taxes. The LAO, in its previous analysis, assumed property taxes would not be assessed and the resulting annual credit would reduce the state's costs. Based upon interpretations of similar situations by the Board of Equalization, it now seems likely that the properties would be subject to property taxation and the state would not receive the property tax credit. (See Exhibit A at 3.)

- **Right of First Refusal**. If the owner receives an offer from a third party for the purchase of one or more of the properties, the state would have an opportunity to purchase the property under the same terms as the third-party offer. (See Exhibit A at 4.)
- **Repurchase**. The proposed lease does not include any provision for the state to repurchase the property at a reduced rate or for the properties to revert to state ownership at the end of the lease. (See Exhibit A at 4.)
- **Upgrades**. The owner would repaint all interior surfaces every five years and replace all floor coverings every ten years. (See Exhibit A at 4.)
- **Subleasing**. The state may sublease any portion of the space. (See Exhibit A at 4.)

These lease terms would apply to all of the properties with the exception of the California Emergency Management Agency Headquarters. Due to the building's specialized purpose in responding to emergencies, DGS structured the proposed lease so that the state would maintain responsibility for all building services. (See Exhibit A at 4.)

40. Most shocking among these terms is the guaranteed ***10% escalator in rents every five years***. While the rent is to be set at market rates at the beginning

of the state's initial 20-year rental period, it is easy to see that rents will quickly surpass market rates, to the detriment of California's taxpayers who spent decades paying for these eleven properties only to become renters instead of owners.

41. In marketing materials, CB Richard Ellis and the DGS touted astonishing Projected Year 1 Net Operating Income ("NOI"), or first-year profits, for the state's new landlord. Specifically, CB Richard Ellis' website reflects the following NOI projections:

Building	**Projected Year 1 Net Operating Income**
Ronald Reagan State Building	$12,195,530
The San Francisco Civic Center, also known as the Earl Warren / Hiram Johnson Building	$22,040,256
Public Utilities Commission Building	$6,098,050
Junipero Serra State Building	$6,799,418
Elihu Harris Building	$12,613,763
California Emergency Management Agency Headquarters	$2,921,246
Attorney General Building	$9,708,584
Capitol Area East End Complex	$35,543,577
Department of Justice Building	$4,936,426
Franchise Tax Board Complex	$34,310,182
Judge Rattigan Building	$1,040,445
Total *First Year* Projected NOI	$148,207,478

See Exhibit D at 3.

42. The sale of these eleven properties to California First LLC represents an unprecedented transfer of tax payer funds to private investors. By the state's own estimates, it confers a first year benefit of nearly $150 million on its chosen purchaser. (See Exhibit D at 3.)

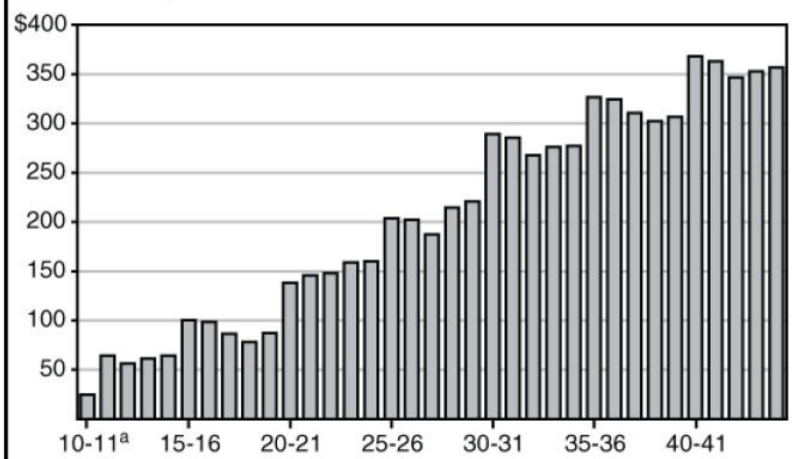
43. As shown in the figure below, which was prepared by the LAO, the estimated difference between the cost of maintaining ownership and the cost of

leasing the buildings would increase over time. In the near term, the greater cost of leasing compared to ownership would average about $54 million over the first five years. However, the estimated cost differential would increase to over $300 million annually in later years.

Figure 5

Annual Cost of Sale-Leaseback Compared To State Ownership, Nominal Dollars

(In Millions)



[a]2010-11 costs represent half of the fiscal year.

(Exhibit A at 9.)

44. In total, the LAO estimates that the total cost of the sale-leaseback would be approximately $6 billion more than the cost of state ownership over a 35-year period, as reflected in the following graph prepared by LAO:

Figure 6

LAO Methodology: Comparison of State Ownership Costs and Leaseback Costs Over 35 Years

(In Millions)

	Nominal	Net Present Value
Status Quo	$5,617	$2,824
Sale-Leaseback	11,607	4,269
Net Cost of Sale-Leaseback	**-$5,990**	**-$1,445**

(Exhibit A at 9.)

45. A simple way to measure the cost in present value terms is to think of the sale-leaseback as a loan with interest – the state receives cash up front through the sale with the obligation to pay it back over time through lease payments. Under such a calculation, the state's effective interest rate would be 10.2 percent. This interest rate is greater – about double – than those the state is currently paying on the buildings' outstanding lease-revenue bonds and greater than the interest rates on the state's recently issued general obligation bonds. (See Exhibit A at 9-10.)

E. SALE BARRELS FORWARD DESPITE UNCONTRADICTED EVIDENCE OF LONG-TERM COSTS TO TAXPAYERS

1. Non-Partisan Legislative Analyst's Office Issues Negative Findings and Warns of Long-Term Consequences

46. On November 5, 2010, the nonpartisan Legislative Analyst's Office issued a report to Senator Ducheny, Chair or the Joint Legislative Budget Committee, with the following important conclusions regarding the sale-leaseback of the eleven properties:

- "ABX4 22 was a late addition to the 2009-10 budget agreement ***without significant public discussion of its policy and cost implications***." (Exhibit A at 9-10) (emphasis added)
- "The *2010-11 Budget Act* assumes the sale-leaseback would generate $1.2 billion in General Fund revenue. [¶] The sale-leaseback, however, also would result in additional costs for the state as it pays rent to the new owners. The lease costs would exceed the amount the state would pay if it maintained ownership of the properties." (Exhibit A at 2)
- "[T]he sale-leaseback is poor fiscal policy." (Exhibit A at 2)
- "[T]he ongoing costs of leasing the facilities eventually would exceed the one-time revenue received in 2010-11." (Exhibit A at 5)

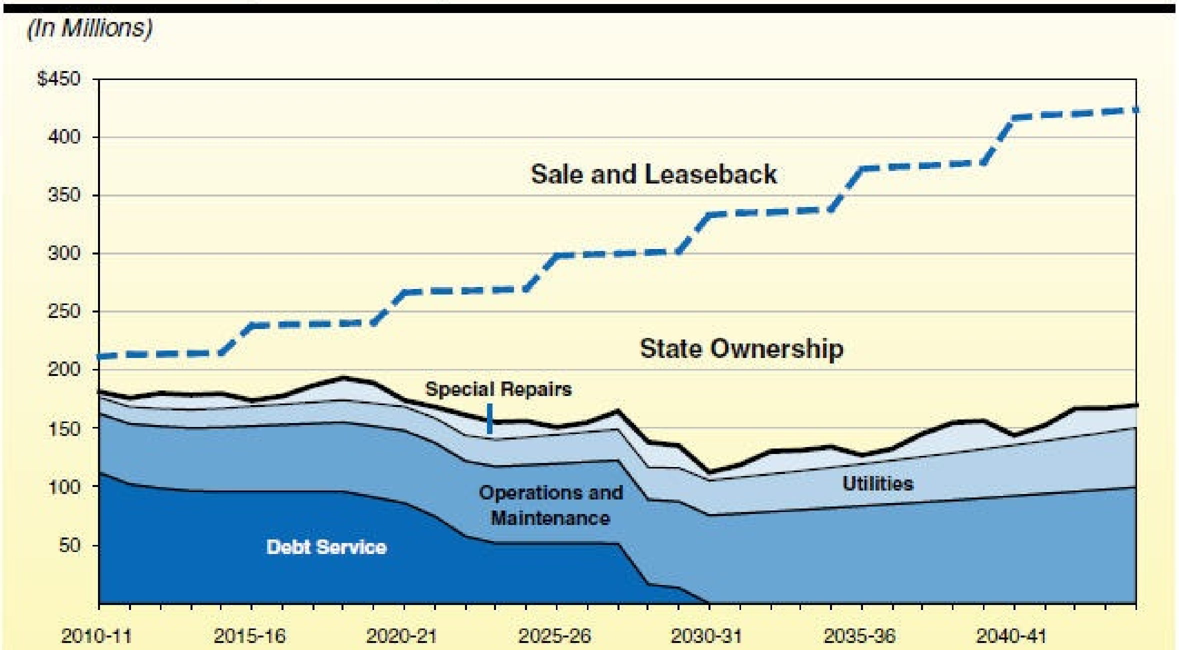
- [T]he sale-leaseback would cost the state $646 million more than the status quo over the first 20 years in present value terms" (Exhibit A at 7)
- "[T]he transaction would be a major fiscal loss even under the shortest possible timeframe." (Exhibit A at 7)
- If a 5 percent discount rate, is used, the net cost of the sale-leaseback in present value terms would range from $1 billion for 20 years to $3 billion for 50 years. (Exhibit A at 7)
- "In total ..., we estimate the total cost of the sale-leaseback would be approximately $6 billion more than the cost of state ownership over the 35-year period." (Exhibit A at 9)
- "A simple way to measure the cost in present value terms is the think of the sale-leaseback as a loan with interest – the state receives cash up front through the sale with the obligation to pay it back over time through lease payments. Under such a calculation, the state's effective interest rate would be 10.2%. This interest rate is greater – about double – than those the state is currently paying on the buildings' outstanding lease-revenue bonds and greater than the interest rates on the state's recently issued general obligation bonds." (Exhibit A at 10)
- The bidding and award processes reveal "questions about how DGS evaluated bids from the public sector" as well as a "troubling . . . paucity of information regarding this major state financial transaction. . . ." (Exhibit A at 10-11 ("Awards Process Lacks Transparency"))

47. The LOA's November 5, 2010 report followed on the heels of its April 27, 2010 report to the Legislature entitled "Evaluating the Sale-Leaseback Proposal: Should the State Sell Its Office Buildings?" – which report reached similar negative conclusions. (The April 27, 2010 Report is attached as Exhibit F

(hereinafter "April 27, 2010 LAO Report").) The April 27, 2010 LAO Report's findings can be summarized in the following LOA-prepared chart which documents the escalating costs of the sale and lease-back versus continued state ownership:

Figure 5

State Ownership Costs Compared to Leaseback Costs



(See Exhibit F at 10.)

48. To date, the independent, non-partisan analysis by the Legislative Analyst's Office has been ignored by the DGS and the Schwarzenegger Administration.

49. DGS has relied upon their own economic analysis of the sale-leaseback while forging ahead with the transaction irrespective of the harm it will cause the state. DGS warns that their analysis is highly speculative, and the reports by the LAO harshly criticize the analysis conducted by DGS. In a letter from DGS to the Honorable Denise Moreno Ducheny, Chair of the Joint Legislative Budget Committee, DGS "strongly caution[s] . . . that economic analysis beyond 10 years in this industry is rare. Forecasting the cost drivers

included in this analysis beyond 20 years becomes ***increasingly speculative and significantly diminishes the confidence of the analysis***." See Letter from DGS to Honorable Denise Moreno Ducheny, Chair Joint Legislative Budget Committee, October 11, 2010, attached hereto as Exhibit G (emphasis added).

IV. CAUSES OF ACTION

FIRST CAUSE OF ACTION

(WRIT OF MANDATE CODE OF CIV. PROC. § 1085)

50. Petitioners/Plaintiffs hereby incorporate by reference all of the foregoing paragraphs as though fully set for herein.

51. Code of Civil Procedure section 1085 provides as follows:

> A writ of mandate may be issued by any court to any inferior tribunal, corporation, board, or person, to compel the performance of an act which the law specially enjoins, as a duty resulting from an office, trust, or station, or to compel the admission of a party to the use and enjoyment of a right or office to which the party is entitled, and from which the party is unlawfully precluded by such inferior tribunal, corporation, board, or person. (Civ. Proc. § 1085, subd. (a).)

52. A Writ of Mandate lies to compel a public official, in this case, the Governor, DGS and Acting Director Diedrich, to perform an official act required by law, in this case, to allow the Judicial Council to exercise its authority and control over the appellate court facilities that are the subject of this suit, ***which it is being unlawfully precluded from exercising by the Department of General Services, its Acting Director Diedrich, and the Governor***. See *Common Cause v. Board of Supervisors* (1989), 49 Cal. 3d 432, 442 (writ of mandate lies to compel a public official to perform an official act required by law.); see also, Decl. of Justice Huffman ¶¶ 8, 9.

53. A writ must issue when there is no plain, speedy, and adequate alternative remedy and the respondent has a duty to perform. See *Payne v. Superior Court* (1976) 17 Cal.3d 908, 925.

54. Petitioners/Plaintiffs have no plain, speedy, or adequate alternative remedy at law to challenge the refusal of the Department of General Services, its Acting Director Diedrich, and the Governor to confer with, and receive the consent of, the Judicial Council regarding the sale and/or lease-back of the appellate court facilities. See *Jenkins v. Knight* (1956) 46 Cal. 2d 220 (where no discretion exists in the law and a ministerial action is imposed upon the executive, an officer of the executive department is subject to judicial process, including a writ of mandamus, just like any other citizen of the state.)

55. Petitioners/Plaintiffs have standing as taxpayers. See *Knoff v. City and County of San Francisco* (1969) 1 Cal. App. 3d 184 (taxpayers have standing to seek a writ of mandamus); see also, *Fuller v. San Bernadino Valley Municipal Water Dist.* (1966) 242 Cal. App. 2d 52, 57 (where the matter is one of public right and the writ seeks performance of a public duty, taxpayer status suffices to establish standing).

SECOND CAUSE OF ACTION

(COMPLAINT FOR INJUNCTIVE RELIEF CODE OF CIV. PROC. § 526)

56. Petitioners/Plaintiffs hereby incorporate by reference all of the foregoing paragraphs as though fully set for herein.

57. The DGS, its Acting Director Diedrich, and the Governor intend to sell the appellate court facilities, including the San Francisco Civic Center – Earl Warren and Hiram Johnson Buildings and the Ronald Reagan State Building, in violation of state law, which requires the concurrence of the Judicial Council. See Decl. of Justice Huffman ¶ 5.

58. The DGS, its Acting Director Diedrich, and the Governor intend to sell and lease-back a total of eleven state properties to a private bidder. The planned sale-leaseback constitutes an illegal expenditure and illegal waste of public funds. It also constitutes an unconstitutional gift of public goods. (Article 16, Section 6 of the California Constitution provides that the Legislature shall not

have the power to "gift or authorize the making of any gift, of any public money or thing of value to any individual, municipal or other corporation.") A cause of action exists for a taxpayer to seek an injunction with regard to the illegal expenditure or waste of public funds pursuant to Cal. Code Civ. Pro. § 526a. That section states:

> An action to obtain a judgment, restraining and preventing any illegal expenditure of, waste of, or injury to, the estate, funds, or other property of a county, town, city or city and county of the state, may be maintained against any officer thereof, or any agent, or other person, acting in its behalf, either by a citizen resident therein, or by a corporation, who is assessed for and is liable to pay, or, within one year before the commencement of the action, has paid, a tax therein. This section does not affect any right of action in favor of a county, city, town, or city and county, or any public officer; provided, that no injunction shall be granted restraining the offering for sale, sale, or issuance of any municipal bonds for public improvements or public utilities.

59. Judicial relief is urgently needed because the DGS, its Acting Director Diedrich, and the Governor intend to complete this sale of the court facilities in or before December 2010. (See Exhibit A at 4.)

60. The DGS, its Acting Director Diedrich, and Governor must be enjoined from violating state law as soon as possible and prior to its occurrence.

61. Because the Judicial Council is entitled by law, and required by law, to exercise the control and authority of an owner over the appellate court facilities of the State, and it is being prevented from exercising its legal authority by the DGS, its Acting Director Diedrich, and Governor, Petitioners/Plaintiffs are likely to succeed on the merits regarding their petition for Writ of Mandate and/or its declaratory relief cause of action. Decl. of Justice Huffman ¶¶ 8, 9.

62. Petitioners/Plaintiffs further have a valid legal remedy under Cal. Code Civ. Pro. § 526a, as taxpayers of the State of California, to prevent the waste of public funds.

63. Petitioners/Plaintiffs are entitled to the relief demanded, and the relief, or any part thereof, consists in restraining the commission or continuance of the act complained of herein.

64. Petitioners/Plaintiffs will suffer irreparable injury because the Judicial Council, and its members, are charged with exercising control over the State's appellate court facilities. Decl. of Justice Huffman ¶ 5. By selling and leasing-back the San Francisco Civic Center – Earl Warren and Hiram Johnson Buildings and the Ronald Reagan State Building, without consulting, or obtaining the consent of the Judicial Council, the DGS, its Acting Director Diedrich, and Governor act in direct contravention of the Judicial Council's lawful authority and legal duty to act, and the Judicial Council's ability to fulfill its statutory duty is negated, entirely, by the DGS, its Acting Director Diedrich, and Governor's unlawful conduct. Id.

65. Petitioners/Plaintiffs will further suffer irreparable injury as taxpayers of the State of California should the sale of the eleven state properties proceed. Once the sale closes, the state will no longer own the properties at issue and will be contractually obligated, under oppressive terms, to pay a private landlord above-market rent for a period of at least twenty years, costing taxpayers billions in the long-term. (See Exhibit A.)

66. In addition, Petitioners/Plaintiffs are without an adequate remedy at law. If the DGS, its Acting Director Diedrich, and the Governor are not enjoined from violating state law, Petitioners/Plaintiffs will suffer a breach of their rights rendering any judgment ineffectual.

67. The facts and circumstances of this case warrant preliminary injunctive relief under Code of Civil Procedure section 527.

/ / /

THIRD CAUSE OF ACTION
(COMPLAINT FOR DECLARATORY RELIEF UNDER
CODE OF CIV. PROC. § 1060)

68. Petitioners/Plaintiffs hereby incorporate by reference all of the foregoing paragraphs as though fully set forth herein.

69. An actual controversy has arisen and now exists between Petitioners/Plaintiffs and Respondents/Defendants concerning their respective rights and obligations with respect to responsibility, jurisdiction, control and authority over the appellate court facilities found in the San Francisco Civic Center – Earl Warren and Hiram Johnson Buildings and the Ronald Reagan State Building. As set forth more fully elsewhere in this complaint, the Judicial Council, and its members, possess responsibility, jurisdiction, control and authority over the appellate court facilities at issue; whereas, Respondents/Defendants, DGS, its Acting Director Diedrich, and the Governor, intend to sell the facilities to a private company, without the consent of the Judicial Council. Respondent/Defendants have contravened governing law by stripping the Judicial Council of its authority over the subject facilities. Decl. of Justice Huffman ¶¶ 5-9.

70. In addition, an actual controversy has arisen and now exists between Petitioners, as taxpayers of the State of California, and Respondents, concerning their respective rights and obligations with respect to the sale and lease-back of public facilities and whether the sale and lease-back violates the State Constitution, Article 16, Section 6 and constitutes an unconstitutional gift of public funds to the selected purchaser, California First LLC. Petitioners seek to enforce their rights and to declare Respondents obligations under the law. In particular, Petitioners ask this court to declare that the DGS, its Acting Director Diedrich, and the Governor are prohibited under the State Constitution, Article 16, Section 6, from proceeding with the sale and lease-back of the 11 properties in the

"Golden State Portfolio", as the sale on the proposed terms represents and unconstitutional gift of public property.

71. Petitioners/Plaintiffs seek to enforce their rights and to declare Respondents/Defendants obligations under the law. In particular, Petitioners/Plaintiffs ask this court to declare that the DGS, its Acting Director Diedrich, and Governor are legally required under state law to refrain from selling or leasing-back the San Francisco Civic Center – Earl Warren and Hiram Johnson Buildings and the Ronald Reagan State Building in the absence of the approval and consent of the Judicial Council.

PRAYER FOR RELIEF

72. WHEREFORE, Petitioners/Plaintiffs pray that judgment be entered against Respondents/Defendants, and each of them as follows:

1. For a **Writ of Mandate** pursuant to Code of Civil Procedure section 1085 compelling the DGS, its Acting Director Diedrich, and the Governor to refrain from selling and/or leasing back any appellate court facilities, including those found in the San Francisco Civic Center – Earl Warren / Hiram Johnson Building and the Ronald Reagan State Building, without the consent and approval of the Judicial Council;

2. For a **Writ of Mandate** pursuant to Code of Civil Procedure section 1085 compelling the DGS, its Acting Director Diedrich, and the Governor to cease and desist acting to sell the Eleven Buildings in violation of the Constitution and the laws of the State of California;

3. For a **Preliminary and Permanent Injunction**, against Respondents/Defendants predicated on the claims presented herein, enjoining them, their agents, servants, employees, and all persons acting under, in concert with, or for them, from: (1) selling and/or leasing-back the eleven state-owned properties that comprise the “Golden State Portfolio” on the terms of sale currently proposed, and from, (2) selling and/or leasing-back the appellate court facilities

found in the San Francisco Civic Center – Earl Warren and Hiram Johnson Buildings and the Ronald Reagan State Building, without the consent and approval of the Judicial Council;

4. For **Declaratory Relief** that the Respondents/Defendants are legally required under state law to refrain from selling and/or leasing the appellate court facilities found in the San Francisco Civic Center – Earl Warren and Hiram Johnson Buildings and the Ronald Reagan State Building, without the consent and approval of the Judicial Council;

5. For **Declaratory Relief** that the Respondents/Defendants are prohibited under the State Constitution, Article 16, Section 6, from proceeding with the sale and lease-back of the 11 properties in the "Golden State Portfolio", as the sale on the proposed terms represents and unconstitutional gift of public property;

6. For attorneys fees pursuant to Code of Civ. Proc. § 1021.5;

7. For costs of suit incurred herein;

8. For such costs and further relief as the Court deems just and proper.

Dated: November16, 2010

COTCHETT, PITRE & McCARTHY

By: ______________________
JOSEPH W. COTCHETT
Attorneys for Petitioners/Plaintiffs

VERIFICATIONS

I, JERRY B. EPSTEIN, declare that I have read the attached **VERIFIED PETITION FOR WRIT OF MANDATE AND COMPLAINT FOR INJUNCTIVE AND DECLARATORY RELIEF** and know its contents. Subject to any inadvertent errors or omissions, the information contained in the Petition and Complaint is true of my own knowledge, except as to matters stated on information and belief and as to those matters I believe them to be true. I reserve the right to correct any inadvertent errors or omissions in this document that may come to my attention.

I declare under penalty of perjury under the laws of the State of California and the United States of America that the foregoing is true and correct to the best of my knowledge.

Dated: November 16, 2010

JERRY B. EPSTEIN

VERIFICATIONS

I, A. REDMOND DOMS, declare that I have read the attached **VERIFIED PETITION FOR WRIT OF MANDATE AND COMPLAINT FOR INJUNCTIVE AND DECLARATORY RELIEF** and know its contents. Subject to any inadvertent errors or omissions, the information contained in the Petition and Complaint is true of my own knowledge, except as to matters stated on information and belief and as to those matters I believe them to be true. I reserve the right to correct any inadvertent errors or omissions in this document that may come to my attention.

I declare under penalty of perjury under the laws of the State of California and the United States of America that the foregoing is true and correct to the best of my knowledge.

Dated: November 15, 2010

A. REDMOND DOMS

EXHIBIT A

LAO

November 5, 2010

Hon. Denise Moreno Ducheny, Chair
Joint Legislative Budget Committee
Room 5035, State Capitol
Sacramento, California 95814

Dear Senator Ducheny:

Chapter 20, Statutes of 2009 (ABX4 22, Evans), authorizes the Department of General Services (DGS) to (1) sell the 11 state-owned office properties shown in Figure 1 and (2) lease the buildings back from the new owners through a long-term lease. The legislation provides broad authority for DGS to determine the sale and lease terms that are "in the best interest of the state." In order to maintain oversight of the process, however, the legislation requires DGS to report on the terms and conditions of the sale-leaseback to the Legislature's fiscal committees 30 days prior to completing the transaction. Additionally, the Assembly Committee on Accountability and Administrative Review requested that DGS provide an analysis of the costs and benefits of the sale-leaseback at 20-, 30-, 40-, and 50-year intervals as part of the department's report on the terms and conditions. The Director of DGS provided these materials to you on October 11, 2010. Typically, the administration adheres to the Legislature's wishes in these types of notification periods—although it is not legally required to do so.

Figure 1
State Office Properties Authorized for Sale-Leaseback

Building	Location
Junipero Serra State Building	Los Angeles
Ronald Reagan State Building	Los Angeles
Elihu Harris Building	Oakland
California Emergency Management Agency Headquarters	Rancho Cordova
Attorney General Building	Sacramento
Capitol Area East End Complex	Sacramento
Department of Justice Building	Sacramento
Franchise Tax Board Complex	Sacramento
Public Utilities Commission Building	San Francisco
Earl Warren and Hiram Johnson Buildings (Civic Center)	San Francisco
Judge Rattigan Building	Santa Rosa

As you know, ABX4 22 was a late addition to the 2009-10 budget agreement without significant public discussion of its policy and cost implications. As a result, it made sense for the legislation to include a period for legislative notification so that the final outcome could be more closely scrutinized. Other than the notification, however, the legislation provides complete authority to the administration to determine the lease terms, select a buyer, and complete the transaction. The recently enacted 2010-11 budget agreement anticipates the revenue from the sale-leaseback. Below, we provide a summary and analysis of the proposed transaction. Some of the topics covered below respond to specific questions from legislative requests.

INTRODUCTION

A sale-leaseback is a real estate transaction in which the owner sells a property and then leases it back from the buyer. The purpose of a sale-leaseback is to free up the original owner's equity while allowing the owner to retain use of the property. The state would benefit from the sale-leaseback transaction because the one-time revenue generated from selling the buildings would be available to address the state's current budgetary shortfall. The sale proceeds would first go towards retiring the outstanding lease-revenue bonds associated with some of the buildings. After deducting a small amount for the transaction's costs, the remaining sale proceeds would be deposited in the General Fund. The *2010-11 Budget Act* assumes the sale-leaseback would generate $1.2 billion in General Fund revenue.

The sale-leaseback, however, also would result in additional costs for the state as it pays rent to the new owners. The lease costs would exceed the amount the state would pay if it maintained ownership of the properties. The major consideration, therefore, in evaluating the sale-leaseback transaction is whether the benefit of the one-time revenue from the sale of the facilities is large enough to compensate for the higher costs in subsequent years. In our previous report in April 2010—*Evaluating the Sale-Leaseback Proposal: Should the State Sell Its Office Buildings?*—we estimated that the leasing costs over a 35-year period would exceed the one-time revenue by at least $600 million in present value terms. As a result, we cautioned that the sale-leaseback was not an ideal budget solution because it would add to the state's structural deficit. The administration's selection of a buyer with defined price and lease terms allows us to revisit those projections below. In general, we reach the same conclusion that the sale-leaseback is poor fiscal policy. We have concerns with the methodology that DGS used to prepare its analysis for the Legislature, which we also discuss below.

THE TRANSACTION

Sale Price. The DGS selected the bid from California First LLC for $2.3 billion. Assuming the sale closes by the end of December 2010, we estimate one-time General Fund net revenue of $1.3 billion as shown in Figure 2—slightly more ($66 million) than assumed in the budget package. The minor increase in revenues reflects the later sales date now anticipated, resulting in the state making more debt-service payments prior to the sale than originally projected, and thus having slightly less debt to retire than initially assumed. (The state's higher debt-service payments fully offset the increased proceeds from the sale.) Although the legislation gave DGS the authority to determine most aspects of the sale and lease, it requires the sale price to be no less than market value. The sale price of $2.3 billion meets this condition by all measures of which we are aware.

Figure 2

Estimated General Fund Revenue From Proposed Sale

(In Millions)

Sale Price	$2,330
Less: Remaining Debt	-1,053
Less: Transaction Costs	-12
General Fund Revenue	**$1,266**

Lease Terms. The authorizing legislation allowed DGS to determine the lease terms for the leaseback. In bid materials, DGS requested that all bids conform to a modified gross lease structure with the following components for ten of the properties:

- ***Type of Lease.*** Under a modified gross lease, the owner would be responsible for paying most building services including building management, janitorial, maintenance, special repairs, insurance, and scheduled upgrades. The owner would pay utilities with the exception of gas and electricity costs, which the state would pay. The state also would continue to provide security at those buildings with unique security needs.

- ***Lease Term.*** The initial lease would be for 20 years. After the initial term, the state would have the option to renew the lease under the same lease conditions for six additional terms of five years each—resulting in a total lease term of potentially 50 years.

- ***Annual Rent Payments.*** Base rent payments would be set near current market rents for each property. The base rent would increase by 10 percent every five years.

- ***Operating Cost Escalator.*** On top of the base rent payments, the state would be responsible for paying annual changes in the owner's operating expenses. The operating costs would be set at a fixed amount when the buildings are purchased and adjusted each year by the change in the Consumer Price Index to reflect inflation.

- ***Property Tax Credit.*** Under the California Constitution, the state is exempt from paying property taxes on the properties it owns. Private landlords renting space to the state, however, generally are charged property taxes based on the assessed value of their properties. The base rent included in the proposed lease assumes that property taxes would be assessed on the properties and that the new owner would make those payments. In the event that the properties remain exempt from property taxes, the lease terms entitle the state to an annual credit against its rent equal to the amount built in for such taxes. In our previous analysis, we assumed property taxes would not be assessed and the resulting annual credit would reduce the state's costs. Based upon interpretations of similar situations by the Board of Equalization, it now seems likely that the properties would be subject to property taxation and the state would not receive the property tax credit.

- ***Right of First Refusal.*** If the owner receives an offer from a third party for the purchase of one or more of the properties, the state would have an opportunity to purchase the property under the same terms as the third-party offer.
- ***Repurchase.*** The proposed lease does not include any provision for the state to repurchase the property at a reduced rate or for the properties to revert to state ownership at the end of the lease.
- ***Upgrades.*** The owner would repaint all interior surfaces every five years and replace all floor coverings every ten years.
- ***Subleasing.*** The state may sublease any portion of the space.

These lease terms would apply to all of the properties with the exception of the California Emergency Management Agency Headquarters. Due to the building's specialized purpose in responding to emergencies, DGS structured the proposed lease so that the state would maintain responsibility for all building services.

Transition to Private Ownership. The department expects the transaction to be complete by the end of December 2010. The sale of the properties would remove over 7 million square feet from DGS' portfolio of managed space. In addition to staff reductions for on-site personnel such as building management and janitors, we anticipate such a portfolio reduction would also cause some restructuring within DGS' management. At this time, DGS has not provided any information on the plan for the transition from state to private ownership. Without a plan on which to base costs, our analyses of the cost of implementing the sale-leaseback assume all of the state's operating costs stop immediately upon the sale. A more realistic scenario (but harder to forecast) is that the implementation of staff reductions and internal restructuring will take some time and the state will continue to incur some operating costs after the sale. It is also likely, although we do not know the department's plans, that the state agencies occupying these facilities would continue to pay some overhead fee to DGS in addition to the rent charged by California First LLC under the sale-leaseback. Because these anticipated costs are not included in the following analyses, it is possible that the following forecasts slightly understate the state's cost of the leaseback. Given that the downsizing of DGS' portfolio and transition to private ownership will have budgetary effects, we recommend that the Legislature request details on the department's transition plan before next spring's budget hearings.

FISCAL ANALYSIS

As mentioned previously, the major fiscal consideration is whether the benefit of the one-time revenue from selling the facilities is large enough to compensate for the higher costs of leasing the facilities in the subsequent years. The department's notification letter included an analysis of the estimated cost of maintaining state ownership of the buildings—the status quo—and compared it to the cost of the sale-leaseback. Below, we assess DGS' economic analysis and then update the analysis from our earlier report.

DGS Analysis

As shown in Figure 3, DGS compared the cost of the sale-leaseback to the status quo (in nominal and present value terms) for multiple time intervals. In present value terms (that is, adjusted to account for the fact that money available at the present time is worth more than money available in the future), the department's analysis concluded that pursuing the sale-leaseback would result in $2 million of savings in the first 20 years, but that the cost of the sale-leaseback would exceed the cost of state ownership over the longer time periods. In other words, the ongoing costs of leasing the facilities eventually would exceed the one-time revenue received in 2010-11. As discussed in the nearby box, DGS asserts that the costs and savings occurring after the first 20 years are not relevant.

Figure 3

DGS Comparison of State Ownership Costs and Leaseback Costs

(In Millions)

	Years 1 to 20	Years 1 to 30	Years 1 to 40	Years 1 to 50
Nominal Comparison				
Status quo cost	$4,385	$7,936	$12,709	$16,285
Sale-leaseback costs	6,172	10,750	16,672	24,291
Net Cost (-) of Sale-Leaseback	**-$1,787**	**-$2,814**	**-$3,963**	**-$8,006**
Net Present Value Comparison				
Status quo cost	$2,202	$2,817	$3,297	$3,480
Sale-leaseback costs	2,200	3,070	3,656	4,049
Net Benefit (+)/Cost (-) of Sale-Leaseback	**$2**	**-$253**	**-$359**	**-$569**

DGS = Department of General Services

20-Year Analysis Insufficient to Measure Effects of Sale-Leaseback

The Department of General Services (DGS) asserts that state costs and savings occurring after the initial 20-year lease term are not relevant. In our view, the department's approach misrepresents the fiscal effect of the sale-leaseback because it excludes significant state fiscal effects occurring in later years. For example, it does not account for the significant state costs in year 21 related to renewing the lease or leasing, buying, or building alternative space for these government functions. It also ignores the continuing escalation of state rent costs under the leaseback and the declining costs of state ownership as the outstanding bonds on the facilities are fully retired. Although DGS is correct that there is some uncertainty in forecasting later year costs and savings, we think that any analysis of the sale of long-term assets must consider them.

As with any forecast, DGS makes many assumptions and acknowledges the large uncertainties associated with estimating building ownership costs. Although different from some of our assumptions, we think DGS' assumptions about future growth rates for variables such as construction and utility costs are reasonable. We disagree with some of DGS' other assumptions, however, which we think overstate the potential costs and risks of the state continuing to own the buildings and make the sale-leaseback appear more favorable than it actually would be.

Estimated Renovation Costs Too High. The department's forecast assumes that under the status quo the state would conduct infrastructure studies and perform extensive renovations of the properties as they become older. While this is a reasonable assumption, the cost DGS assumes for future renovations is too high. The DGS assumes future renovations would cost $250 per square foot (adjusted for inflation over time) based upon the recent costs of renovating two other state office properties: Office Buildings 8 and 9 and the Library and Courts building. Selecting these two properties as the cost basis for future renovations represents the worst-case scenario, as these were total renovations that included almost complete demolition and replacement of existing interiors and building systems as well as exterior renovations and the abatement of hazardous materials. Additionally, the renovation of Office Buildings 8 and 9 included the addition of a new two-story reception building and childcare center that added to the square foot costs. Similarly, the Library and Courts building is a state historical landmark, and its high renovation costs reflected the state's efforts to maintain the building's historic architecture and finishes. It is possible that *some* of the buildings in the sale-leaseback portfolio could require such extensive renovations as Office Buildings 8 and 9 and the Library and Courts building. It is not reasonable, however, to assume all of the buildings would. This is particularly true given the fact that most buildings in the portfolio are newer and in better condition than Office Buildings 8 and 9 and the Library and Courts building were prior to their renovation. Based on our analysis, we estimate the average cost of future infrastructure renovations would be about one-third less than DGS' estimates.

Insurance Costs Too High. The state does not maintain insurance on buildings once the bonds used to fund construction are retired. The state's decision to self-insure reduces annual costs, but increases the financial risk of potential property damage. The department's analysis, however, assumes that the state purchases property and earthquake insurance under the status quo. The DGS asserts this is necessary to quantify the benefit of transferring this risk to the new owner. While we agree that it is important to include some calculation of risk, we think this approach somewhat overstates the cost of maintaining state ownership by creating costs that the state does not currently incur and double counting some costs that are already included elsewhere in DGS' model. For example, the state's current operating costs—on which DGS bases its operating cost forecast—already reflect the recent annual costs of any liability claims or property damage. Additionally, the state's policy not to insure its buildings is based upon the evaluation that the annual cost of insurance exceeds the potential cost of insurable property damage. For example, by self-insuring, the state avoids the overhead and profit margins built into insurance premiums. We think it is reasonable to include some cost for risk, but think DGS' assumptions overstate that cost by about 25 percent.

Reversionary Value Calculated Incorrectly. As mentioned above, the department's status quo forecast assumes that the state fully invests in the maintenance and renovation of the 11 facilities. Such an investment would extend the useful life of the facilities beyond the time periods included in the analysis. Accordingly, DGS includes a reversionary value for the properties, or an estimate of the properties' value at the end of each term. Including the reversionary value takes into account the benefit of owning the properties—for example, the value that could be derived from occupying those buildings for their remaining useful life or from selling them. We take issue, however, with the department's methodology for calculating the reversionary value. The department calculates the reversionary value of the properties at a 50-year discounted value and then applies that value to each time period. For example, at the end of the first 20 years, DGS discounts the reversionary value of the properties by 50 years rather than the appropriate 20 years. In our view, this approach makes no sense and has the effect of understating the remaining value of the buildings. The department provided no rationale for its approach.

Update of DGS Model Shows Sale-Leaseback Has Significantly Higher Cost. As described above, we have three concerns with DGS' analysis of the status quo:

- The cost of future property renovations is overstated by about 33 percent.
- The cost of insuring against property and earthquake damage is overstated by roughly 25 percent.
- The value of the properties at the end of each time interval is understated.

Figure 4 summarizes our findings after making our adjustments to DGS' calculations. Specifically, under this approach the sale-leaseback would cost the state $646 million more than the status quo over the first 20 years in present value terms. In contrast to DGS' analysis, therefore, the transaction would be a major fiscal loss even under the shortest possible timeframe. The cost of the transaction grows to $725 million over 30 years and approximately $830 million in present value terms when looking out 50 years. The estimates shown in Figure 4 assume the discount rates selected by DGS—an average of about 6 percent. (The discount rate is used to adjust future amounts to present dollars.) As we discuss later in this letter, we think 5 percent is a more appropriate discount rate for this transaction. If we modify the analysis described above to include a 5 percent discount rate, the net cost of the sale-leaseback in present value terms would range from $1 billion for 20 years to $3 billion for 50 years. (For 35 years, the time period we use in our analysis below, the net cost is about $1.4 billion.)

Figure 4

Net Present Value of Sale-Leaseback

(In Millions)

	Years 1 to 20	Years 1 to 30	Years 1 to 40	Years 1 to 50
Department of General Services (DGS) Analysis	$2	-$253	-$359	-$569
LAO Revision of DGS Analysis	-646	-725	-732	-831

LAO Fiscal Analysis

In addition to reviewing DGS' fiscal analysis of the sale-leaseback, we examined the proposed transaction using the methodology that we developed for our April report. Our approach and assumptions differ from the department's forecast in several respects. Most notably, we used 35 years for the evaluation period because it represents a reasonable remaining useful life for the buildings in the portfolio and because it is likely the state would extend its leases on these properties due to their role in providing government services, historic status, or proximity to other government facilities. In forecasting the cost of maintaining state ownership, we attempted not to understate the potential costs and risks of the state continuing to own the buildings. Although not representing the worst-case scenario, we sought to provide significant allowances for major repairs and minor renovations. Our cost estimate does not include the potential costs of major renovations, and also does not acknowledge the residual value of the buildings and land at the end of the forecast period. We assume these values would tend to offset each other. In other words, we forecast just enough funding for capital renewal to keep the buildings operational through the forecast period and then assume no residual value or useful life beyond 35 years.

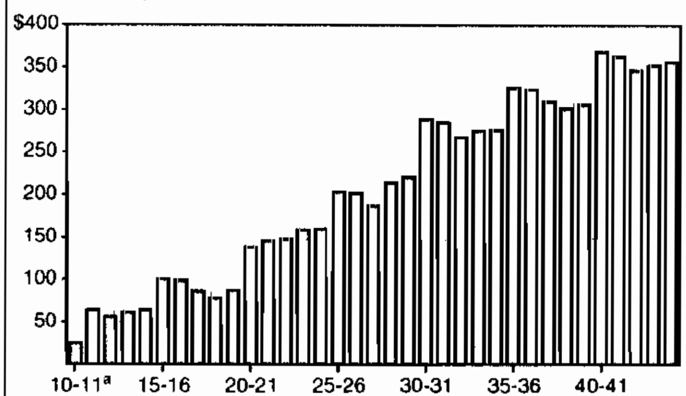
We also use a lower discount rate than DGS (5 percent rather than DGS' variable rate averaging about 6 percent). The discount rate used in a forecast is also a sensitive and critical factor that can affect the outcome. The discount rate selected should consider such factors as the anticipated inflation rate, borrowing costs, and the Legislature's valuation of the future. We typically use a lower discount rate based upon the expectation that government should not heavily discount the costs that future generations will bear. Our use of a lower discount rate places more value on costs incurred in later years, which results in higher present value costs compared to DGS' forecast.

As shown in Figure 5, the estimated difference between the cost of maintaining ownership and the cost of leasing the buildings would increase over time. In the near term, the greater cost of leasing compared to ownership would average about $54 million over the first five years. However, the estimated cost differential would increase to over $300 million annually in later years.

Figure 5

Annual Cost of Sale-Leaseback Compared To State Ownership, Nominal Dollars

(In Millions)



[a]2010-11 costs represent half of the fiscal year.

In total, as shown in Figure 6, we estimate the total cost of the sale-leaseback would be approximately $6 billion more than the cost of state ownership over the 35-year period. In present value terms, the difference is considerably less because the greatest costs occur in the latter part of the 35-year period and thus are heavily discounted. Still, in present value terms, the sale-leaseback costs are approximately $1.4 billion more than the status quo under our analysis. This increase over our earlier forecast reflects our updated assumption regarding property taxes. Specifically, we now assume that the property owners will be assessed property taxes and these costs will be passed through to the state. Although some of these additional property taxes could modestly alter the state's education costs, we did not include these effects in our analysis because we do not expect them to be significant. (While increases in property taxes paid generally offset state General Fund costs for schools, property tax increases in redevelopment areas can actually result in increased state costs due to the 2004 vehicle license fee swap.)

Figure 6

LAO Methodology: Comparison of State Ownership Costs and Leaseback Costs Over 35 Years

(In Millions)

	Nominal	Net Present Value
Status Quo	$5,617	$2,824
Sale-Leaseback	11,607	4,269
Net Cost of Sale-Leaseback	**-$5,990**	**-$1,445**

A simple way to measure the cost in present value terms is to think of the sale-leaseback as a loan with interest—the state receives cash up front through the sale with the obligation to pay it back over time through lease payments. Under such a calculation, the state's effective interest rate would be 10.2 percent. This interest rate is greater—about double—than those the state is currently paying on the buildings' outstanding lease-revenue bonds and greater than the interest rates on the state's recently issued general obligation bonds.

Summary of Fiscal Effects

In summary, over a 35-year period, both the DGS and the LAO analysis show the cost of the sale-leaseback to be about $1.4 billion (assuming a 5 percent discount rate) or about half this amount assuming a 6 percent discount rate. Considering this in terms of the state budget, the cost of the sale-leaseback is quite clear. Maintaining ownership of the buildings would lead to decreasing costs over time, but at the cost of creating a major hole in the 2010-11 budget plan. Alternatively, the rising cost of leasing the facilities would lead to an increase in the state's structural problem, but help balance the budget in the current year.

THE BIDDING AND AWARD PROCESS

The legislation exempted DGS from established state bidding and award procedures without specifying any procedures or criteria for DGS to follow in bidding and awarding the sale-leaseback. As such, DGS had significant discretion in determining the award procedures. The process started with DGS selecting the firm CB Richard Ellis (CBRE) through a competitive bidding process to serve as the broker for marketing and managing the sale-leaseback transaction. Next, DGS worked with CBRE to prepare lease terms for the leaseback part of the transaction and determine the bidding and selection process for the buyer.

As we understand it, the selection process consisted of multiple bidding rounds. At this time, DGS has not provided details on the rejected bids, but reported that the initial round resulted in 11 offers exceeding $2 billion. The DGS interviewed these final 11 bidders and invited each to submit a "best and final" offer. Unlike the competitive bidding process for the sale-leaseback broker and the typical awarding of state contracts, the sale process did not have any published criteria or scoring system for evaluating the bids, and the final award announcement did not include a ranking of each qualified bid. According to DGS, however, the final bids were evaluated based on two factors:

- ***Best and Final Price.*** According to DGS, the selected bid from California First LLC offered the highest purchase price at $2.3 billion.
- ***Certainty of Execution.*** Due to the size and complexity of the transaction, DGS wanted to ensure that buyers could meet the bid price with minimal risk. The DGS reported that evaluation criteria for this category included the bidders' diligence in reviewing the properties, financial backing, ability to remove contingencies, and ability to close the transaction quickly. Based on these criteria, California First LLC would have scored well given that it relies on 40 percent private equity and 60 percent financing from JP Morgan.

Given that DGS expected all the bids to conform to specified lease terms, it is likely that price and certainty of execution accounted for most of the variation among the bids. Other factors that could have varied include the experience and performance of the proposed property managers, the property tax implications of a private sector rather than public sector buyer, and the treatment of the properties at the end of the lease term. It is our understanding that to the extent the department considered these other factors, DGS gave them significantly less weight than price and certainty. As described earlier, such weighting was DGS' decision because the legislation provided DGS significant authority to determine the "best interests of the state" in the sale and leaseback of the properties.

Comparison of Public and Private Buyer. We have also received questions about how DGS evaluated bids from the public sector. Although the unselected bids have not been made public, our conversations with DGS and others have indicated that some public sector entities bid on the properties. While we cannot confirm the terms of those bids, we understand they included a public joint powers authority financing the purchase of the state's properties through the issuance of tax-exempt municipal bonds. Some of the advantages and disadvantages of a public bid are summarized in Figure 7. While the advantages of the public option are easier to quantify, the risk and uncertainties associated with the public option are also apparent. Based upon DGS' evaluation criteria outlined above, it is possible that concerns about completing the transaction could be a reason DGS did not choose the public option. The DGS also reported that California First LLC provided the highest price and, therefore, met both of their key criteria of price and certainty.

Figure 7

Potential Advantages and Disadvantages of Public Option[a]

Advantages	Disadvantages
• ***Property Tax.*** Public buyer probably not assessed property tax. Potential net present value savings to the state of over $700 million compared to private buyer.	• ***Less Certainty in Execution.*** Financing of properties depends upon bond market and investors. Price not guaranteed until bonds are sold.
• ***Property Reversion.*** If public bid includes reversion of properties to state at end of 50-year lease, potential net present value savings to the state of approximately $250 million to $400 million.	• ***Delay.*** Transaction would take longer to close due to preparation of bond sale documents.

[a] Based upon our understanding of submitted offers Actual terms of those bids could be different.

Award Process Lacks Transparency. Evaluating DGS' award of the sale-leaseback purchase is difficult given the limited information the department has provided regarding the bidding process and individual bids. Overall, in contrast to DGS' usual sales and procurement procedures, it appears that the department did not use a specific (objective or subjective) point system for ranking bids based on established criteria. In addition, it appears that the department does not a have a clear process to allow unsuccessful bidders to file protests. In discussing these matters with DGS, it indicated that the special circumstances relating to this transaction made it difficult for them to follow their usual procedures. Specifically, DGS expressed concern that a selected bidder might withdraw or revise its bid during the 30-day legislative notification period if information about competing bids were to be publically available. While we acknowledge the potential risks associated with the usual procedures for governmental transparency, we find the paucity of information regarding this major state financial transaction to be troubling.

CONCLUSION

In our previous analysis, we pointed out that the sale-leaseback was poor fiscal policy and represented one imperfect option among many for balancing the state's budget. We recommended the Legislature strongly consider other alternatives to the sale-leaseback in putting together the 2010-11 budget. The inclusion of the sale-leaseback revenue as part of the 2010-11 budget package suggests that alternative solutions were less favorable or not feasible. Mainly due to changes in the interpretation of property tax assessments, our forecast of the cost of the sale-leaseback is approximately $800 million greater than our previous analysis. The Legislature may wish to consider whether this increase in costs merits changing course. If you have any questions about this analysis, please contact Mark Whitaker at (916) 319-8335.

Sincerely,

Michael Cohen
Deputy Legislative Analyst

Enclosure

cc: Members of the Joint Legislative Budget Committee
Assembly Committee on Accountability and Administrative Review

EXHIBIT B

ORIGINAL

June 9, 2006

File No. 2749-003
Agency Name: Judicial Council of California

Macanan Investments
333 West Santa Clara Street, Suite 280
San Jose, CA 95113

Certified Mail/Return Receipt Requested
7003 1010 0004 5242 2863

Under lease dated November 8, 2001, the State hires from you certain premises located at 333 West Santa Clara Street, Suite 1060, in the City of San Jose, County of Santa Clara, State of California, for a period ending January 31, 2012, at a monthly rental of $9,926.13.

Effective July 1, 2006, the Administrative Office of the Courts and Judicial Council (hereafter referred to as the "AOC") will replace the Department of General Services (DGS) identified in said lease as the State of California. Due principally to the Separation of Powers doctrine between the Executive and Judicial branches of State government, and also to the recent enactment of SB-1732 in 2003, the DGS has agreed to the AOC's request to assign all current leases from DGS to the AOC. The AOC also has a new administrative branch to service leasehold interests.

*

Therefore, pursuant to paragraph 17 of the lease the state may assign this lease in its entirety upon written consent of the lessor. The State hereby requests lessors' approval to assign this lease in its entirety to the Administrative Office of the Courts and Judicial Council effective July 1, 2006. Lessor further agrees to release the DGS from any obligations which may be due thereunder by lessee from the effective date herein. Accordingly, paragraph 5 "Notices" of said lease shall be changed to reflect the legal address for future correspondence with the State of California as follows:

Katherine Albertus
Portfolio Administration Analyst
Office of Court Construction and Management
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
Phone: (415) 865-8828
Fax: (415) 865-7524

and

Melvin Kennedy
Managing Attorney, Real Estate Unit
Office of the General Counsel
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102

If the State's assignment of said premise as set forth above is satisfactory to you, please indicate your agreement by signing this document and the attached copies at the bottom of the page. Keep one copy for your records and return the original and two copies to this Office for our records.

Sincerely,

STATE OF CALIFORNIA

DEPARTMENT OF GENERAL SERVICES
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

BY:
JEFF NEWBURY,
Real Estate Officer
(916) 375-4176

APPROVED:

DIRECTOR OF THE DEPARTMENT
OF GENERAL SERVICES

BY:
GEOFF T. MCLENNAN,
Acting Manager
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

Receipt of the foregoing letter is acknowledged, and the undersigned hereby agrees.

Date: 6/13/2016

BY:

Title: GENERAL PARTNER
MACANAN INVESTMENTS

If the State's assignment of said premise as set forth above is satisfactory to you, please indicate

your agreement by signing this document and the attached copies at the bottom of the page. Keep one copy for your records and return the original and two copies to this Office for our records

ACCEPTED

STATE OF CALIFORNIA
JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS

BY: Kristine Hansen
CHRISTINE HANSEN,
Chief Financial Officer

Date: 8/8/06

cc: Lupe Espinoza, Office of the State Controller
New Assignee:
Katherine Albertus
Portfolio Administration Analyst
Office of Court Construction and Management
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
New Assignee:
Melvin Kennedy
Managing Attorney, Real Estate Unit
Office of the General Counsel
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
Geoff T. McLennan, Lease Management Unit, Real Estate Services Division
Chris Duval, SPI Unit, Real Estate Services Division
Asset Planning and Enhancement Branch (APE)

State of California • Arnold Schwarzenegger, Governor
State and Consumer Services Agency

DEPARTMENT OF GENERAL SERVICES

Real Estate Services Division – Professional Services Branch

June 9, 2006

ORIGINAL

File No. 3534-001
Agency Name: Judicial Council Court of Appeals

Certified Mail/Return Receipt Requested
7003 1010 0004 5242 2887

Charles G. Logue & Candy S. Logue
130 E. Carillo Street
Santa Barbara, CA 93101

Under lease dated October 21, 1993, as amended June 5, 1997 and October 29, 1998, the State hires from you certain premises located at 200 East Santa Clara Street, in the City of Ventura, County of Ventura, State of California, for a period ending June 30, 2009, at a monthly rental of $69,143.10.

Effective July 1, 2006, the Administrative Office of the Courts and Judicial Council (hereafter referred to as the "AOC") will replace the Department of General Services (DGS) identified in said lease as the State of California. Due principally to the Separation of Powers doctrine between the Executive and Judicial branches of State government, and also to the recent enactment of SB-1732 in 2003, the DGS has agreed to the AOC's request to assign all current leases from DGS to the AOC. The AOC also has a new administrative branch to service leasehold interests.

Therefore, pursuant to paragraph 17 of the lease the state may assign this lease in its entirety upon written consent of the lessor. The State hereby requests lessors' approval to assign this lease in its entirety to the Administrative Office of the Courts and Judicial Council effective July 1, 2006. Lessor further agrees to release the DGS from any obligations which may be due thereunder by lessee from the effective date herein. Accordingly, paragraph 5 "Notices" of said lease shall be changed to reflect the legal address for future correspondence with the State of California as follows:

Katherine Albertus
Portfolio Administration Analyst
Office of Court Construction and Management
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
Phone: (415) 865-8828
Fax: (415) 865-7524

and

Melvin Kennedy
Managing Attorney, Real Estate Unit
Office of the General Counsel
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102

If the State's assignment of said premise as set forth above is satisfactory to you, please indicate your agreement by signing this document and the attached copies at the bottom of the page. Keep one copy for your records and return the original and two copies to this Office for our records.

Sincerely,

STATE OF CALIFORNIA

DEPARTMENT OF GENERAL SERVICES
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

BY: Jeff Newbury
JEFF NEWBURY,
Real Estate Officer
(916) 375-4176

APPROVED:

DIRECTOR OF THE DEPARTMENT
OF GENERAL SERVICES

BY: Geoff T. McLennan
GEOFF T. MCLENNAN,
Acting Manager
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

Receipt of the foregoing letter is acknowledged, and the undersigned hereby agrees.

Date: 6-29-06

BY: Charles Logue by His Attorney in Fact
Title: Travis C. Logue

If the State's assignment of said premise as set forth above is satisfactory to you, please indicate

your agreement by signing this document and the attached copies at the bottom of the page. Keep one copy for your records and return the original and two copies to this Office for our records

ACCEPTED

STATE OF CALIFORNIA
JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS

BY: Christine Hansen
CHRISTINE HANSEN,
Chief Financial Officer

Date: 7/31/06

cc: The Becker Group, Inc., P.O.Box 23277 , Ventura, CA 93002
Lupe Espinoza, Office of the State Controller
New Assignee:
Katherine Albertus
Portfolio Administration Analyst
Office of Court Construction and Management
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
New Assignee:
Melvin Kennedy
Managing Attorney, Real Estate Unit
Office of the General Counsel
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
Geoff T. McLennan, Lease Management Unit, Real Estate Services Division
Chris Duval, SPI Unit, Real Estate Services Division
Asset Planning and Enhancement Branch (APE)

11

State of California • Arnold Schwarzenegger, Governor
State and Consumer Services Agency

DEPARTMENT OF GENERAL SERVICES

Real Estate Services Division – Professional Services Branch

ORIGINAL

June 9, 2006

File No. 2961-001
Agency Name: Judicial Council of California

French Park Place, Ltd.
1933 Port Bishop Place
Newport Beach, CA 92660

Certified Mail/Return Receipt Requested
7003 1010 0004 5242 2894

Under lease dated April 20, 1998, as amended August 11, 1989, the State hires from you certain premises located at 925 North Spurgeon Street, in the City of Santa Ana, County of Orange, State of California, for a period ending November 30, 2008, at a monthly rental of $98,669.31.

Effective July 1, 2006, the Administrative Office of the Courts and Judicial Council (hereafter referred to as the "AOC") will replace the Department of General Services (DGS) identified in said lease as the State of California. Due principally to the Separation of Powers doctrine between the Executive and Judicial branches of State government, and also to the recent enactment of SB-1732 in 2003, the DGS has agreed to the AOC's request to assign all current leases from DGS to the AOC. The AOC also has a new administrative branch to service leasehold interests.

Therefore, pursuant to paragraph 17 of the lease the state may assign this lease in its entirety upon written consent of the lessor. The State hereby requests lessors' approval to assign this lease in its entirety to the Administrative Office of the Courts and Judicial Council effective July 1, 2006. Lessor further agrees to release the DGS from any obligations which may be due thereunder by lessee from the effective date herein. Accordingly, paragraph 5 "Notices" of said lease shall be changed to reflect the legal address for future correspondence with the State of California as follows:

Katherine Albertus
Portfolio Administration Analyst
Office of Court Construction and Management
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
Phone: (415) 865-8828
Fax: (415) 865-7524

and

Melvin Kennedy
Managing Attorney, Real Estate Unit
Office of the General Counsel
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102

If the State's assignment of said premise as set forth above is satisfactory to you, please indicate

your agreement by signing this document and the attached copies at the bottom of the page. Keep one copy for your records and return the original and two copies to this Office for our records.

Sincerely,

STATE OF CALIFORNIA

DEPARTMENT OF GENERAL SERVICES
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

BY: Jeff Newbury
JEFF NEWBURY,
Real Estate Officer
(916) 375-4176

APPROVED:

DIRECTOR OF THE DEPARTMENT
OF GENERAL SERVICES

BY: Geoff T. McLennan
GEOFF T. MCLENNAN,
Acting Manager
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

Receipt of the foregoing letter is acknowledged, and the undersigned hereby agrees.

Date: 27 June 2006

BY: Lawrence B Moore
Title: Partner, French Park Place, Ltd.

If the State's assignment of said premise as set forth above is satisfactory to you, please indicate

your agreement by signing this document and the attached copies at the bottom of the page. Keep one copy for your records and return the original and two copies to this Office for our records

ACCEPTED

STATE OF CALIFORNIA
JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS

BY Christine Hansen
CHRISTINE HANSEN,
Chief Financial Officer

Date: 7/31/06

cc: Lupe Espinoza, Office of the State Controller
New Assignee:
Katherine Albertus
Portfolio Administration Analyst
Office of Court Construction and Management
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
New Assignee:
Melvin Kennedy
Managing Attorney, Real Estate Unit
Office of the General Counsel
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
Geoff T. McLennan, Lease Management Unit, Real Estate Services Division
Chris Duval, SPI Unit, Real Estate Services Division
Asset Planning and Enhancement Branch (APE)

State of California • Arnold Schwarzenegger, Governor
State and Consumer Services Agency
DEPARTMENT OF GENERAL SERVICES
Real Estate Services Division – Professional Services Branch

June 9, 2006

File No. 4888-001
Agency Name: Judicial Council of California

CTF4-Civic Center, LLC
c/o Essex Realty Management
3146 Redhill Avenue, Suite 150
Costa Mesa, CA 92626

Certified Mail/Return Receipt Requested 7003 1010 0004 5242 2900

Under lease dated August 22, 2001, the State hires from you certain premises located at 500 West Santa Ana Blvd., Suite 400, in the City of Santa Ana, County of Orange, State of California, for a period ending November 30, 2008, at a monthly rental of $16,106.26.

Effective July 1, 2006, the Administrative Office of the Courts and Judicial Council (hereafter referred to as the "AOC") will replace the Department of General Services (DGS) identified in said lease as the State of California. Due principally to the Separation of Powers doctrine between the Executive and Judicial branches of State government, and also to the recent enactment of SB-1732 in 2003, the DGS has agreed to the AOC's request to assign all current leases from DGS to the AOC. The AOC also has a new administrative branch to service leasehold interests.

Therefore, pursuant to paragraph 17 of the lease the state may assign this lease in its entirety upon written consent of the lessor. The State hereby requests lessors' approval to assign this lease in its entirety to the Administrative Office of the Courts and Judicial Council effective July 1, 2006. Lessor further agrees to release the DGS from any obligations which may be due thereunder by lessee from the effective date herein. Accordingly, paragraph 5 "Notices" of said lease shall be changed to reflect the legal address for future correspondence with the State of California as follows:

Katherine Albertus
Portfolio Administration Analyst
Office of Court Construction and Management
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
Phone: (415) 865-8828
Fax: (415) 865-7524

and

Melvin Kennedy
Managing Attorney, Real Estate Unit
Office of the General Counsel
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102

If the State's assignment of said premise as set forth above is satisfactory to you, please indicate your agreement by signing this document and the attached copies at the bottom of the page. Keep one copy for your records and return the original and two copies to this Office for our records.

Sincerely,

STATE OF CALIFORNIA

DEPARTMENT OF GENERAL SERVICES
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

BY: Jeff Newbury
JEFF NEWBURY,
Real Estate Officer
(916) 375-4176

APPROVED:

DIRECTOR OF THE DEPARTMENT
OF GENERAL SERVICES

BY: Geoff McLennan
GEOFF T. MCLENNAN,
Acting Manager
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

Receipt of the foregoing letter is acknowledged, and the undersigned hereby agrees.

Date:________________

CTF4 - Civic Center LLC, a California limited liability company

BY:________________

Title:________________

By: CT California Fund IV, LLC, a California limited liability company
Its: Manager

By: CT Fund Manager IV, LLC, a California limited liability company
Its: Manager

By: ________________
Larry Mathena
Its: Executive Vice President

If the State's assignment of said premise as set forth above is satisfactory to you, please indicate

your agreement by signing this document and the attached copies at the bottom of the page. Keep one copy for your records and return the original and two copies to this Office for our records.

ACCEPTED

STATE OF CALIFORNIA
JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS

BY: Christine Hansen
CHRISTINE HANSEN,
Chief Financial Officer

Date:____________________

cc: Lupe Espinoza, Office of the State Controller
New Assignee:
~~Katherine Albertus~~
Portfolio Administration Analyst
Office of Court Construction and Management
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
New Assignee:
Melvin Kennedy
Managing Attorney, Real Estate Unit
Office of the General Counsel
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
Geoff T. McLennan, Lease Management Unit, Real Estate Services Division
Chris Duval, SPI Unit, Real Estate Services Division
Asset Planning and Enhancement Branch (APE)

June 26, 2006

File No: 2647-004
Agency Name: Judicial Council of California

Symphony Tower LLC
750 B Street, Suite 1900
San Diego, CA 92101
ATTN: Shelly Blevins

VIA OVERNIGHT MAIL

Under lease dated March 12, 2001, the State hires from you certain premises located at 750 'B' Street, Suite 380, in the City of San Diego, County of San Diego, State of California, for a period ending May 31, 2010, at a monthly rental of ~~$3,873.45~~. $4,031.55 smb

Effective July 1, 2006, the Administrative Office of the Courts and Judicial Council (hereafter referred to as the "AOC") will replace the Department of General Services (DGS) identified in said lease as the State of California. Due principally to the Separation of Powers doctrine between the Executive and Judicial branches of State government, and also to the recent enactment of SB-1732 in 2003, the DGS has agreed to the AOC's request to assign all current leases from DGS to the AOC. The AOC also has a new administrative branch to service leasehold interests.

Therefore, pursuant to paragraph 17 of the lease the state may assign this lease in its entirety upon written consent of the lessor. The State hereby requests lessors' approval to assign this lease in its entirety to the Administrative Office of the Courts and Judicial Council effective July 1, 2006. Lessor further agrees to release the DGS from any obligations which may be due thereunder by lessee from the effective date herein, in all of such obligations are hereby assumed by the AOC. Accordingly, paragraph 5 "Notices" of said lease shall be changed to reflect the legal address for future correspondence with the State of California as follows:

Katherine Albertus
Portfolio Administration Analyst
Office of Court Construction and Management
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102
Phone: (415) 865-8828
Fax: (415) 865-7524

and

Melvin Kennedy
Managing Attorney, Real Estate Unit
Office of the General Counsel
Judicial Council of California – Administrative Office of the Courts
455 Golden Gate Avenue
San Francisco, CA 94102

If the State's assignment of said premise as set forth above is satisfactory to you, please indicate your agreement by signing this document and the attached copies at the bottom of the page. Keep one copy for your records and return the original and two copies to this Office for our records.

Sincerely,

STATE OF CALIFORNIA

DEPARTMENT OF GENERAL SERVICES
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

BY: Jeff NewBury
JEFF NEWBURY,
Real Estate Officer
(916) 375-4176

ACCEPTED

STATE OF CALIFORNIA
JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS

BY: Christine Hansen
CHRISTINE HANSEN,
Chief Financial Officer

APPROVED:

DIRECTOR OF THE DEPARTMENT
OF GENERAL SERVICES

BY: [signature] for Geoff McLennan
GEOFF T. MCLENNAN
Acting Manager
REAL ESTATE SERVICES DIVISION
PROFESSIONAL SERVICES BRANCH

Receipt of the foregoing letter is acknowledged, and the undersigned hereby agrees.

SYMPHONY TOWER LLC

by: THE IRVINE COMPANY LLC, a Delaware limited liability company, Its Managing Member

Date: September 7, 2006

BY: [signature]
STEVEN M. CASE
Senior Vice President, Leasing
Office Properties

LEGAL APPROVAL

BY: [signature]
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EXHIBIT C

Los Angeles Times ARTICLE COLLECTIONS

← Back to Original Article
Opinion

State should keep ownership of its buildings

Its plan to sell office buildings and then rent space in them -- a decision made without public hearings or expert advice -- is yet another accounting gimmick that will cost taxpayers in the end.

April 06, 2010 | By Jerry B. Epstein

Imagine you are deeply in debt. But you are also less thau a year away from paying off the mortgage on a nice home that you want to coutinue liviug in. Someone comes in and offers you enough money to pay off a small portion of yonr ontstanding bills if yon will sell them yonr house. As part of the deal, yon would have to live in the honse for 20 years, paying rent to the new owners that would amouut to many times what you were paid for the house. Would you do it? Not likely.

Yet, late last summer, with little study and without pnblic hearings or input from the real estate experts who serve on the relevant state building authorities, Gov. Arnold Schwarzenegger and the Legislature agreed to sell 11 state office building complexes, inclnding the Ronald Reagan and Junipero Serra state buildings in downtown Los Angeles. The decision was made as part of a deal to close the state's $20-billion 2009-10 budget deficit. Today this fire sale is moving forward, commou sense notwithstanding, and it's happening at a time when prices for commercial real estate are in a severe slump.

For 30 years, under Democratic and Republican governors, the state has lowered the cost of office space for its courts, cmployees and agencies by constructing state-owned buildings. Most of thc buildings on the "for sale" list are paid off or ncarly paid off. By selling off and then leasing back these state office buildings, California is obligating itself to pay market rent for the next 20 years, with no anticipated new revenue to pay for it.

Worse still, even if the state gets the price it's hoping for on the buildings, the estimated nct proceeds of about $650 million will be enough to cover only a few years' worth of future rent payments. And getting a good pricc is a big if. California's recent attempt to sell the Orange County Fairgrouuds fell apart last month when the state rejected the highest bid it got -- $56.5 million. The bid was much lower than the state's estimated value of the property, which was betwccn $96 million and $180 million.

I havc a personal stake in seeiug this foolish plan tabled. Since 1983, the first year of George Deukmejian's two terms as governor, I have servcd on the Los Angeles State Building Authority, a three-person body established to plan, finance and oversee the construction and management of state office facilities in downtown Los Angeles. Two members of the authority are appointed by the governor; the third is appointed by the Los Angeles Community Redevelopment Agency. There are similar entities in other California cities.

These joiut powers authorities were established for many reasons, not the least of which is that the state thought it made good sense to have people with practical experiencc overseeing the design, financiug, construction and managemcnt of large state buildings.

For nearly three decades, the authority has carried out its missiou, completing two state office buildings. Before coustruction of the Ronald Reagan aud the Junipero Serra buildings, the state was paying more than 75 landlords all across Los Angeles County millious of dollars in rent. The coustructiou of the buildings reduced costs and greatly increased efficiency, since more than 50 state agencies could now be housed just a few blocks apart. The buildings also served as a catalyst for the renaissance of downtown Los Angeles.

To fiuancc construction, the state issued lease revenue bonds, so that once the bonds are paid off, the state will own the buildings free and clear. In May 2011, the bonds that fiuanced the Ronald Reagan State Building are scheduled to be paid off.

Neither my colleagues on the authority uor I wcre consulted before this dubions scheme was hatched, though the authority's cooperation is necessary for the exccution of the sale of the Reagan and Serra buildings. In late February, at my direction, counsel to the Los Angeles State Building Authority asked the Department of Geueral Services to provide a market study and to clarify the terms proposed by the Schwarzenegger administratiou. We asked for a comparisou of the projected net proceeds from the sale aud the projected rental and other costs associated with a 20-year leaseback of these same buildings. Our letter made it clear that the authority has a fiduciary responsibility to the bondholders as well as to the taxpayers of the state, and that no formal decision by the authority would be made uutil it could hear testimouy about the proposed sale, thereby ensuring that the benefits and costs of the proposed transactiou had been fully vetted.

Three weeks later, I got my response in a terse two-sentence letter signed by Ronald Diedrich, acting director of the state Department of General Services: "This is to formally advise you that as of March 17, 2010, I have appointed new members to tbe governing board of the Los Angelcs State Building Authority and decided not to reappoint you. Your prior services have been greatly appreciated." Earlier in March the governor-appointed members of the Sau Francisco State Building Authority werc also summarily dismissed. They, too, were skeptical of Schwarzeuegger's plan.

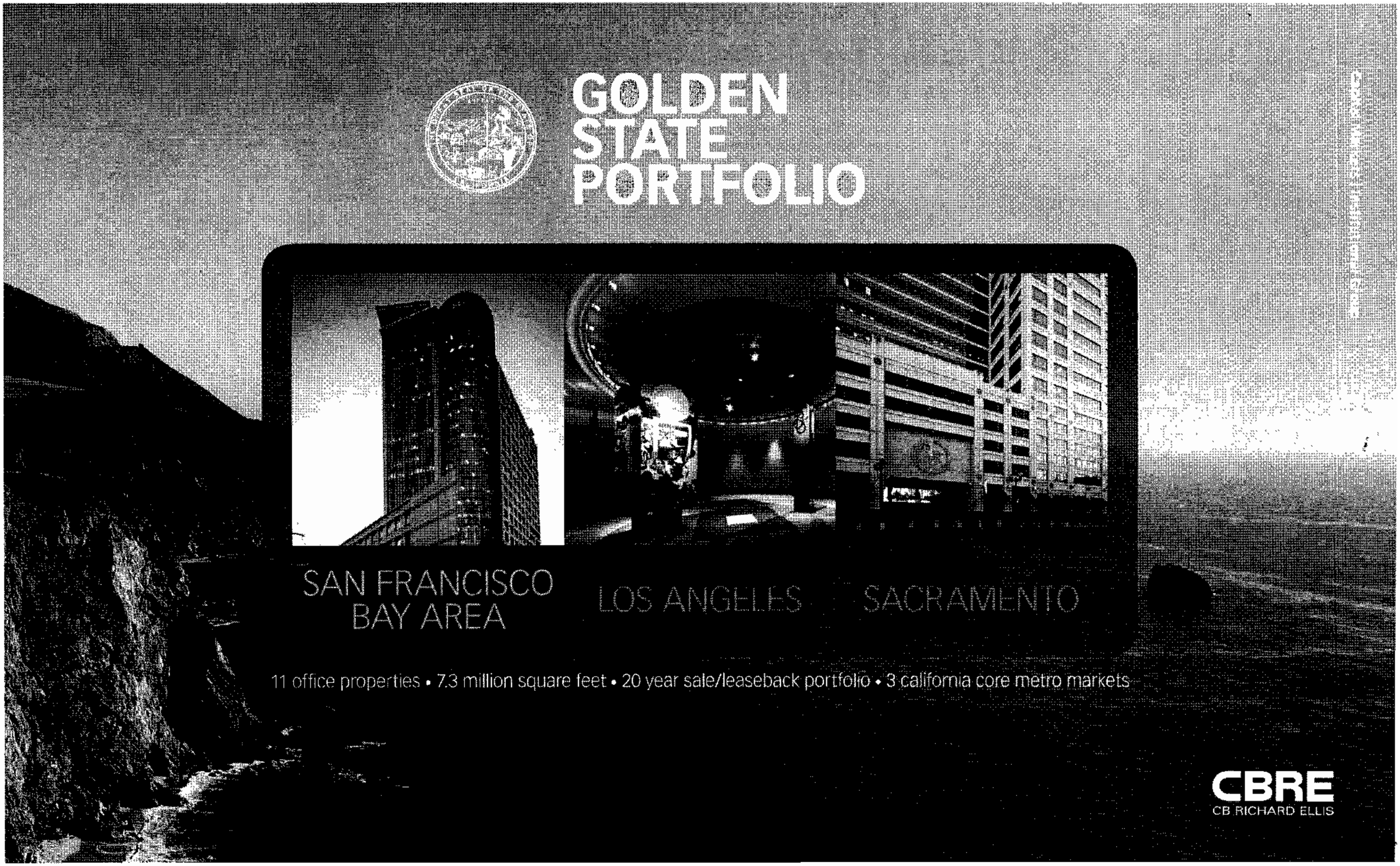
At 86 years old, I am not personally concerned about having been fired. I have served on the authority for nearly 30 years and never received a penny for my services and time.

But I am concerned that we taxpayers may have no refuge from the poor judgment and dysfuuctiou of our state government. Short-term solutions and accounting gimmicks like the proposed sale of state buildings have long-term consequences. The governor aud legislators should fix the state's budget problems we face through thoughtful, strnctural solutious, not carelessly conceived, short-term political fixes that will cost us all more in the long run.

Jerry B. Epstein is the former president of the Los Angeles State Building Authority and a developer in Marina del Rey. He has also served as president of the

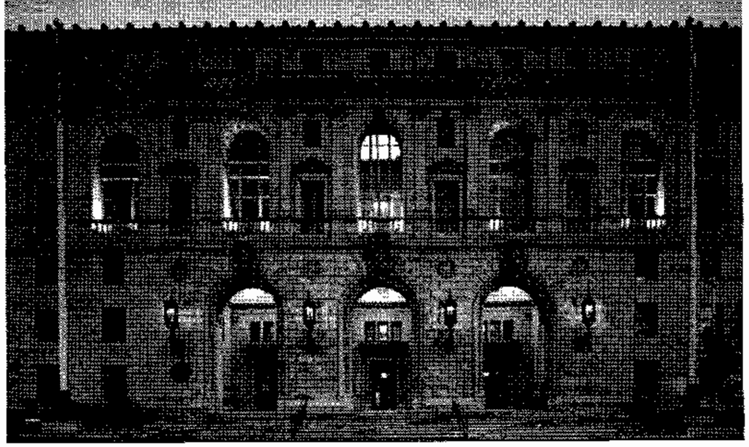
Los Angeles Board of Airport Commissioners and chairman of the California Transportation Commission.

EXHIBIT D


Capital Markets | Institutional Group
GOLDEN
STATE
PORTFOLIO
SAN FRANCISCO
BAY AREA
LOS ANGELES
SACRAMENTO
11 office properties • 7.3 million square feet • 20 year sale/leaseback portfolio • 3 california core metro markets
CBRE
CB RICHARD ELLIS

*CB Richard Ellis, as exclusive advisor to the State of California, is pleased to present the opportunity to acquire the fee simple interest in the **Golden State Portfolio**, an eleven property, 7.3 million square foot office sale/leaseback portfolio located in the San Francisco Bay Area, Los Angeles and Sacramento markets. The Portfolio offers an investor a generational opportunity to acquire predominantly LEED® certified office properties in the most desirable state in the nation. The Portfolio can be purchased in its entirety or each of the eleven properties can be purchased individually.*

San Francisco Civic Center



INVESTMENT HIGHLIGHTS

State Of California

The State of California is a critical economic engine for both the United States and the world. Exemplifying a diverse economy that accounts for approximately 13% of the total Gross Domestic Product (GDP) of the United States, California would rank among the top ten nations globally if it were an independent country with an estimated GDP of $1.8 trillion in 2008. As the most populous state in the US with approximately 37 million residents, California is forecast to continue to enjoy future population growth above the national average in part due to its temperate climate, excellent quality of life, diverse population, vast coastline, world-renowned cities and its position as the gateway to the Pacific Rim.

The Golden State Portfolio offers investors a truly generational opportunity to acquire a critical mass of functional and well located, primarily Class A office properties, in core submarkets. These assets are in three of California's major metropolitan markets, which are also three of the top thirty metropolitan markets in the United States. Some of the outstanding features of this offering are listed below:

Desirable California Submarkets

The properties in the Portfolio are in some of the most strategic locations throughout California: San Francisco Bay Area, Los Angeles and Sacramento. Favorable long term demographic trends are forecast in these three highly populated markets.

LEED Certified Critical Mass

Rare opportunity to acquire predominantly LEED certified office buildings. Befitting California's legacy as the nation's leader in "green" legislation and technology, 92% of the portfolio is LEED certified (including two pending buildings). Recent LEED studies have demonstrated the ability of LEED projects to obtain higher rents with fewer employee sick days and offer a higher recruitment and employee retention rate, among other benefits.

Flexible Acquisition

The Portfolio is being offered either in its entirety or individually and is being offered free of debt. Several of the properties have existing tax exempt bonds which will be redeemed and/or defeased as part of the sale.

Strategic Facilities

The State of California's commitment to these key facilities is demonstrated by the 20 year lease terms. The State provides the investor a superb captive tenant story based on its current utilization of these Class A facilities and the State's projected increased long term space needs. A recent State of California study completed in March 2009 projected an 80% space increase in the next 40 years for the State of California in the Sacramento market alone.

Investment Grade Tenancy

The 20 year leaseback of the eleven properties by the State of California will enable the investor to enjoy a stable, long-term income stream from an investment grade tenant. The State of California is rated "A-" by Standard & Poor's and its viability assured as the recognized, most desirable state in the nation.

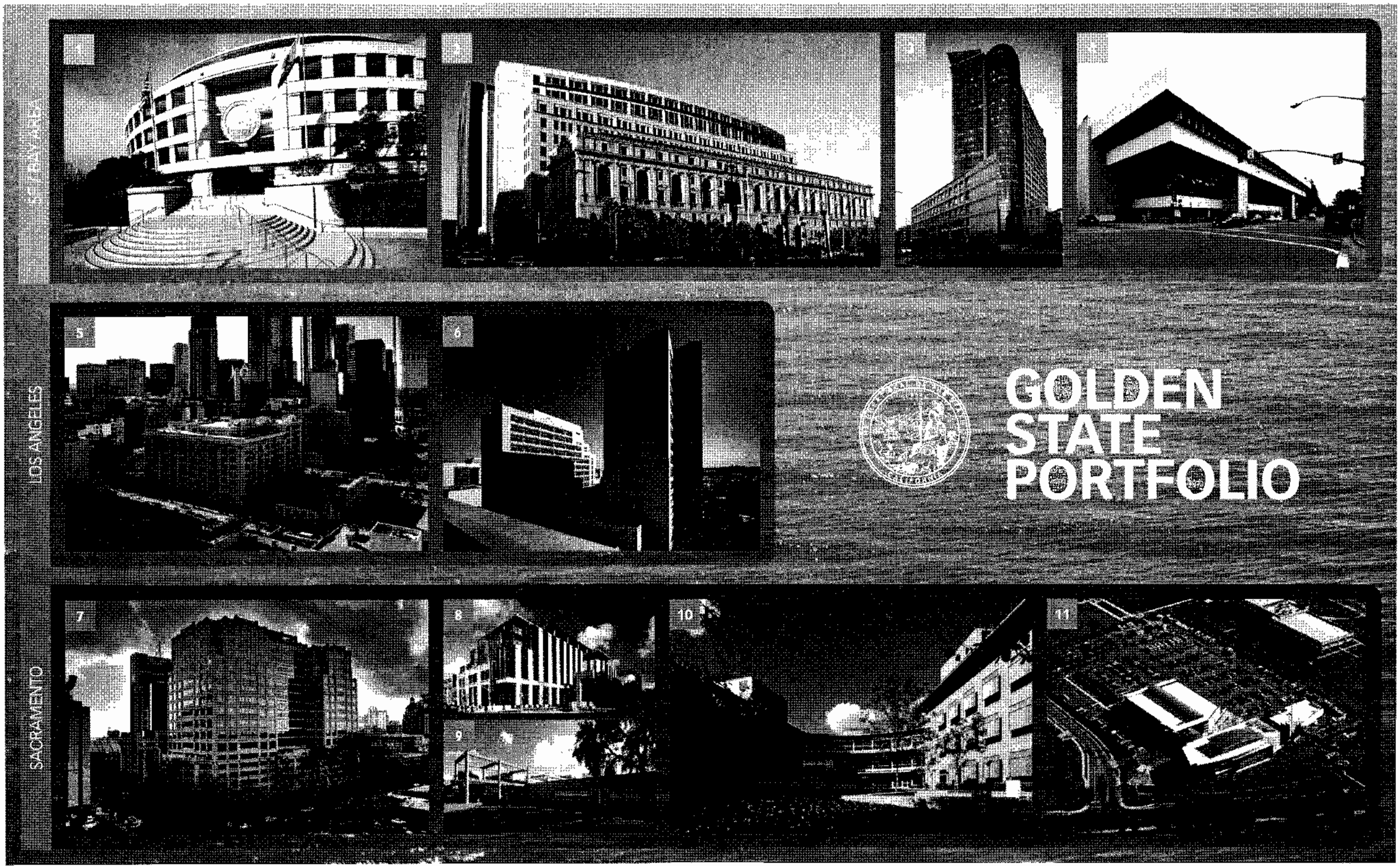
For more information about the Golden State Portfolio, please visit the website:

www.cbre.com/goldenstateportfolio

PORTFOLIO DETAILS

SF / BAY AREA

	Property Name	Address	Rentable Area (SF)	# of Floors	Year Built	LEED Certification	Projected Year 1 NOI
1	**Public Utilities Commission Building**	505 Van Ness Avenue San Francisco	270,768	5	1984	LEED Silver	$6,098,050
2	**San Francisco Civic Center** (Earl Warren & Hiram Johnson Buildings)	350 McAllister Avenue & 455 Golden Gate Avenue San Francisco	912,387	6 & 14	1922 & 1999	LEED Gold (1 bldg)	$22,040,256
3	**Elihu Harris Building**	1515 Clay Street Oakland	700,589	24	1998	LEED Certified	$12,613,763
4	**Judge Rattigan Building**	50 D Street Santa Rosa	92,368	4	1983	Registered	$1,040,445
		SUBTOTAL	**1,976,112**				
5	**Junipero Serra State Building**	320 West 4th Street Los Angeles	431,856	10	1914, 1999 (Renovated)	Registered (w/ certification goal of "Silver")	$6,799,418
6	**Ronald Reagan State Building**	300 South Spring Street Los Angeles	739,158	14 & 16	1989	Registered (w/ certification goal of "Silver")	$12,195,530
		SUBTOTAL	**1,171,014**				
7	**Attorney General Building**	1300 I Street Sacramento	376,866	17	1995	LEED Gold	$9,708,584
8	**Capitol Area East End Complex**	1430 N Street; 1500, 1501, 1615, and 1616 Capitol Avenue Sacramento	1,474,705	6 and 7	2002 & 2003	LEED Platinum (1 bldg), LEED Gold (4 bldgs)	$35,543,577
9	**Department of Justice Building**	4949 Broadway Sacramento	381,718	2	1982	Registered	$4,936,426
10	**Franchise Tax Board Complex**	9645 Butterfield Way Sacramento	1,814,056	1 to 4	1984, 1993, 2003 & 2005	LEED Gold (4 bldgs), LEED Silver (2 bldgs)	$34,310,182
11	**Cal EMA**	3650 Schriever Avenue Rancho Cordova	116,687	1 and 2	2002	Registered	$2,921,246
		SUBTOTAL	**4,164,032**				
		GRAND TOTAL	**7,311,158**				$148,207,477


BAY AREA
LOS ANGELES
SACRAMENTO
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GOLDEN
STATE
PORTFOLIO
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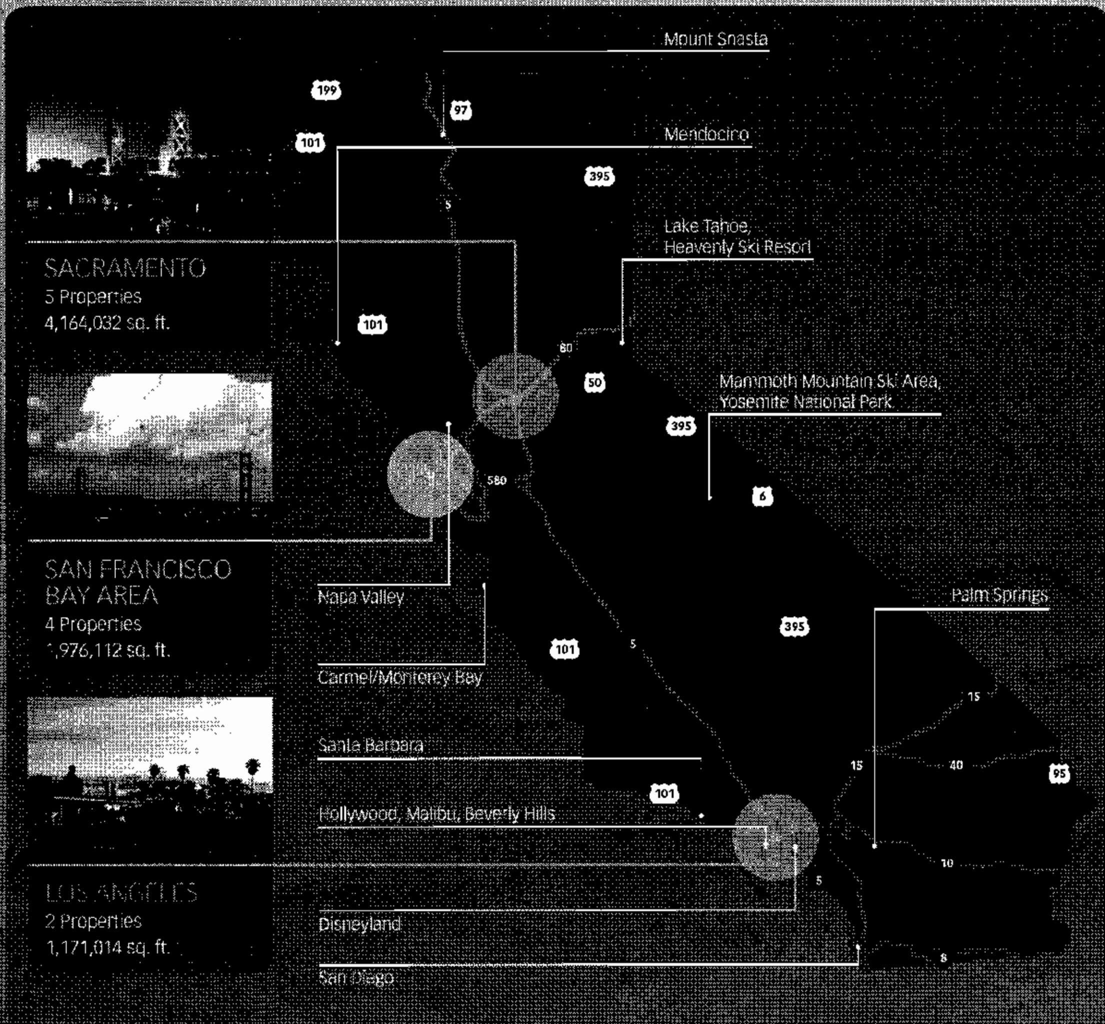

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Bid Date: April 14, 2010

For more information about the Golden State Portfolio opportunity marketing process, time line, buyer selection criteria and further detail about the individual assets, please visit the website:

www.cbre.com/goldenstateportfolio

CBRE
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EXHIBIT E

State of California • Arnold Schwarzenegger, Governor
State and Consumer Services Agency
DEPARTMENT OF GENERAL SERVICES
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FOR IMMEDIATE RELEASE
October 11, 2010

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Downloads:
Original Sale Brochure – DGS Financial Analysis Summary – Video/Photos

State of California Selects Buyer for State Buildings

$2.33 billion Sale-Leaseback Bid Delivers $1 billion to the General Fund; Makes Future Costs for State Office Space Predictable and Controllable

SACRAMENTO, Calif. – Today, the Department of General Services announced it has selected California First, LLC, a partnership led by Hines and Antarctica Capital Real Estate LLC, as the buyer for 11 state office properties authorized by the legislature and Governor last year. The winning offer was $2.33 billion — resulting in more than $1.2 billion for the state general fund, and $1.09 billion to pay off bonds on the buildings. Over the next 20 years, the state will lease the offices back from the new owner at predetermined rates, and will no longer maintain, operate, or repair the buildings. All the leases with California First allow the state to buy back any or all of the buildings at anytime during the 20-year term.

"After an extensive review of the more than 300 bids that were received, I have determined that this offer presents the best value for the state and achieves the goals set forth by the Legislature and Governor," said Acting DGS Director Ron Diedrich. "This sale will allow us to bring in desperately needed revenues and free the state from the ongoing costs and risks of owning real estate."

Hines, a privately owned real estate firm headquartered in Houston, Texas, is involved in real estate investment, development and property management worldwide. The firm's historical and current portfolio of projects that are underway, completed, acquired and managed for third parties includes 1,119 properties representing more than 457 million square feet of office, residential, mixed-use, industrial, hotel, medical and sports facilities, as well as large, master-planned communities and land developments. Antarctica Capital Real Estate, LLC; a venture led by California real estate veteran Rich Mayo of Spyglass Realty Partners, along with Chandra Patel of Antarctica Capital headquartered in Irvine, California and New York, NY, is a private equity firm specializing in real estate. There are also additional equity investors. The all cash offer will utilize a typical debt and equity ratio with the general partners and investors providing approximately 40 percent of the purchase price, and a major financial institution supplying the balance as a loan to the new owners.

Director Diedrich today notified the state legislature of the department's intent to sell the properties – a notification called for under the authorizing legislation. The offices are:

- Attorney General Building, Sacramento
- California Emergency Management Agency Building, Sacramento

- Capitol Area East End Complex, Sacramento
- Elihu M. Harris Building, Oakland
- Franchise Tax Board Complex, Sacramento
- San Francisco Civic Center, San Francisco
- Junipero Serra State Building, Los Angeles
- Department of Justice Building, Sacramento
- Public Utilities Commission Building, San Francisco
- Judge Joseph A. Rattigan Building, Santa Rosa
- Ronald Reagan State Building, Los Angeles

*Sales brochure for the properties.

In his letter to the legislature, Diedrich shared the department's economic analysis summary of the sale comparing the status quo of ownership of the buildings to the sale and leaseback transaction. Using a series of reasonable and prudent assumptions the analysis shows that the sale allows California to retire $1.09 billion in bond debt, leaving over $1.2 billion in new revenues to shore up the state budget, as a result eliminating the need for more program cuts statewide or tax increases. By no longer owning the properties, the state eliminates annual lease payments and interest, as well as operating expenses. The state also sheds the responsibility for deferred and major capital improvements, as well as the obligation to pay for unforeseen and unpredictable repairs that cannot be anticipated but are increasingly likely as the buildings age.

In April, the state's broker, CB Richard Ellis received more than 300 offers to purchase the buildings. The offers included individually priced offers on each building; however, the most aggressive pricing came largely from 30 offers for the entire portfolio. Portfolio buyers were given the opportunity to submit a second round of offers on May 11. CBRE received 16 increased portfolio offers, 11 of which exceeded the state's $2 billion estimate of the value of the properties. Those 11 bidders were then invited to submit a "best and final" offer by May 21.

Since May 21, DGS, in conjunction with its broker, has been evaluating the top offers. This evaluation included a comprehensive analysis of each of the 11 best and final offers which included separate interviews with each finalist. Buyers were evaluated based on a reconciliation of two primary factors – price and certainty of execution. CB Richard Ellis investigated with DGS the bidder's track record; and how much due diligence the bidder had done on the state properties prior to making a buyer selection. Evaluation criteria included whether due diligence reports were reviewed; due diligence inspections were completed; the extent of property tours; the nature of contract and lease comments; the financial backing the buyer had in place and finally, the buyer's ability to both remove contingencies and close the transaction quickly.

"The State of California received significant portfolio interest, and the proceeds at the sale price of $2.33 billion will far exceed the $660 million originally estimated. Far from a fire sale, this was a stiff, multiple offer competition that generated favorable pricing for the state," said Kevin Shannon with CBRE, who handled the sale on behalf of the state. "Current historically low interest rates have allowed the state to obtain extraordinary pricing comparable with peak level capitalization rates with leaseback rents well below peak market levels. An additional benefit is that the state will be getting out of the commercial real estate management business, and transferring asset management to Hines, a globally recognized leader."

The Department of General Services anticipates completing all transactions in the 4th quarter of 2010.

The Department of General Services acts as the business manager for the State of California, with more than 4,000 employees and a budget in excess of $1 billion. DGS helps state government better serve the public by providing services to state agencies including innovative procurement and acquisition solutions, creative real estate management, leasing and design services, environmentally friendly transportation, and architectural oversight and innovative funding for the construction of safe schools.

# # #

EXHIBIT F

LAO

Evaluating the Sale-Leaseback Proposal:

Should the State Sell Its Office Buildings?

MAC TAYLOR • LEGISLATIVE ANALYST • APRIL 27, 2010

LAO Publications

This report was prepared by Mark Whitaker, and reviewed by Steve Boilard. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.

To request publications call (916) 445-4656. This report and others, as well as an E-mail subscription service, are available on the LAO's Internet site at www.lao.ca.gov. The LAO is located at 925 L Street, Suite 1000, Sacramento, CA 95814.

EXECUTIVE SUMMARY

Recent legislation authorized the Department of General Services (DGS) to sell and then lease back 11 state-owned office properties. The sale-leaseback is designed to free up the state's equity in the buildings to provide one-time revenue for addressing the state's current budgetary shortfall. The leaseback component would allow the state to retain use of the properties.

The DGS has initiated the process for selling and leasing back the properties and expects to select a buyer or buyers as early as the end of May. In order to maintain oversight of the process, the legislation requires DGS to report on the terms and conditions of any sale-leaseback to the Legislature's fiscal committees 30 days prior to completing a transaction. During this 30-day period, the Legislature has an opportunity to review the transaction and determine whether the sale-leaseback is preferable to maintaining state-ownership of the buildings. In this report, we outline the key issues the Legislature will need to consider in comparing the sale-leaseback to the status quo.

Major Up Front Benefit...The major benefit of the sale-leaseback transaction is the one-time revenue from the sale of the buildings. Proceeds from the sale would first retire the bonds associated with the buildings, while the remainder would provide one-time revenue to the state's General Fund. The *2010-11 Governor's Budget* estimates sale proceeds would provide $598 million to the General Fund. In the report, we find that the Governor's estimate represents the low end of what the state could expect to receive and that one-time revenue could be $1.4 billion under more optimistic assumptions.

...But Higher Annual Costs. While the sale-leaseback would transfer the state's costs and risk of owning the buildings to the new owner, the state would make ongoing lease payments to the new owner that would be greater than the amount the state currently spends to own and operate the buildings. We estimate leasing the facilities would cost $30 million more than ownership in the first year and continue to increase over time—eventually costing the state approximately $200 million more annually than maintaining ownership.

Evaluating the Transaction. In deciding whether to endorse the sale-leaseback during the 30-day review period, the Legislature will need to consider whether the benefit of the one-time revenue from selling the facilities would be large enough to compensate for the higher costs in subsequent years. After taking into account the one-time revenue that the state would receive in the first year and converting the future costs into today's dollars, we estimate the transaction would cost the state between $600 million and $1.5 billion. The Legislature will need to weigh how these costs compare to other alternatives for addressing the state's budget shortfall. In our view, taking on long-term obligations—like the lease payments on these buildings—in exchange for one-time revenue to pay for current services is bad budgeting practice as it simply shifts costs to future years. Therefore, we encourage the Legislature to strongly consider other budget alternatives. And, more specifically, we recommend the Legislature reject the sale-leaseback if the sales revenue is at the lower end of the range presented in this report—near the Governor's revenue estimate, for example—as the costs would be equivalent of long-term borrowing at double digit interest rates.

BACKGROUND

Chapter 20, Statutes of 2009 (ABX4 22, Evans), authorizes the DGS to (1) sell 11 state-owned office buildings and (2) lease the buildings back from the new owners through a long-term lease. The sale-leaseback transaction was one component of a larger proposal from the Governor to extract revenue from the state's real estate assets. Other components of the Governor's state asset revenue proposal included in Chapter 20 were the sale of the Orange County Fairgrounds and allowing DGS to arrange long-term ground leases for underutilized state properties. Each proposal was intended to provide revenue for addressing the state's budgetary shortfalls. This report addresses the sale-leaseback component of Chapter 20.

The Sale-Leaseback Transaction. A sale-leaseback is a real estate transaction in which the owner sells a property and then leases it back from the buyer. The purpose of a sale-leaseback is to free up the original owner's equity while allowing the owner to retain use of the property. The leaseback component is essential to the state since it will continue to need space in the buildings proposed for sale. As described in the nearby box, a sale-leaseback transaction is much different than a traditional asset sale.

Timeline. The DGS has initiated the process for selling and leasing back the 11 state properties authorized in Chapter 20 (see Figure 1). The process started with DGS selecting the firm CB Richard Ellis (CBRE) through a competitive bidding process to serve as the broker for marketing and managing the sale-leaseback transaction. Next, DGS worked with CBRE to determine the marketing timeline and strategy, compile due diligence information on the properties, and prepare lease terms for the leaseback part of the transaction. As shown in the current timeline in Figure 2, CBRE officially

Figure 1

State Office Properties Authorized for Sale-Leaseback

Building	Location
Junipero Serra State Building	Los Angeles
Ronald Reagan State Building	Los Angeles
Elihu Harris Building	Oakland
California Emergency Management Agency Headquarters	Rancho Cordova
Attorney General Building	Sacramento
Capitol Area East End Complex	Sacramento
Department of Justice Building	Sacramento
Franchise Tax Board Complex	Sacramento
Public Utilities Commission Building	San Francisco
Earl Warren and Hiram Johnson Buildings (Civic Center)	San Francisco
Judge Rattigan Building	Santa Rosa

Figure 2

Sale-Leaseback Schedule

2010	
February 26	Release of initial brochure and offering memorandum.
April 14	Deadline for potential buyers to submit initial offer.
April 23	Competitive buyers invited to participate in additional offer rounds.
May 20	Deadline for best and final bids.
May 28	Anticipated date of the selection of the buyer(s).

placed the properties on the market—advertised as the "Golden State Portfolio"—on February 26. The bidding process began with potential buyers submitting initial offers on one or more of the properties in April. The DGS and CBRE will then evaluate the initial offers and invite potential buyers who submitted competitive initial offers to participate in a "best and final" round at the end of May. Assuming additional bidding rounds are not necessary, a decision on the buyer or buyers could occur as early as the end of May.

The Role of the Legislature. The legislation provides broad authority for DGS to determine the sale and lease terms that are "in the best interest of the state." In order to maintain oversight of the process, however, the legislation requires DGS to report on the terms and conditions of the sale-leaseback to the Legislature's fiscal committees 30 days prior to completing a transaction. This 30-day review period provides the Legislature an opportunity to review the transaction and determine if the state should enter into the agreement. The key policy question the Legislature will have to confront (if DGS successfully negotiates a deal) is whether the sale-leaseback is preferable to maintaining state ownership of the buildings. The purpose of this report is to outline the key issues for comparing the sale-leaseback to the status quo and suggest approaches for evaluating the sale-leaseback transaction.

Selling the Properties in Today's Real Estate Market

Selling at a Low Point in the Market Will Result in Less Revenue... The commercial real estate market has experienced a significant decline during the recession. Increasing vacancy rates have caused commercial building values to drop across the state since 2007. Accordingly, the state would be selling the buildings at a low point in the market and receive less revenue than it would have in previous years.

...But Also Lower Rent Payments. Although the state would not earn the same revenue that it might have in previous years, the state would also not have to pay the higher market rents of previous years when it leases the buildings back. Rental rates in all of California's metropolitan markets have fallen significantly since 2007 as owners attempt to attract new tenants or retain current tenants. The lower rental rates would lessen the state's long-term lease costs under a sale-leaseback.

Sale-Leaseback Should Be Attractive to Investors. Under the sale-leaseback proposal, the state would lease the entire properties for a term of at least 20 years. One advantage of pursuing a sale-leaseback in this market is that with the significant turnover and vacancy rates, there is considerable demand among institutional investors for real estate assets that offer such long leases and secure income streams. The state's buildings would still represent some risk to the new owners depending upon their condition and age, but carry less risk than many other commercial properties that do not offer guaranteed occupancy. As a result, we would expect a competitive bidding environment for the state's sale-leaseback properties.

EVALUATING THE SALE-LEASEBACK

Sale-leasebacks are fairly common in the private sector because the transaction can provide opportunities for companies to decrease their tax liability, improve their balance sheet, or gain capital to reinvest in the company. Fewer public sector entities have engaged in sale-leaseback transactions because most of the benefits experienced by the private sector do not apply to governments. Most government sale-leaseback transactions seek to generate revenue for either immediate budgetary solutions—similar to California—or to provide capital for investing in large projects. (More details on public entities' use of sale-leasebacks are discussed in the nearby box.) Generating revenue from a sale-leaseback, however, also means the state would incur additional costs in later years as it pays rent to the new owners. Below, we discuss these two major considerations—one-time revenue and ongoing lease costs—that the Legislature would need to consider in evaluating the desirability of the proposed sale-leaseback. We then describe other factors concerning the transaction.

SALE-LEASEBACKS IN THE PUBLIC SECTOR

The most prevalent use of sale-leasebacks in the public sector is at the local government level. Governments pursuing sale-leasebacks typically want to extract the equity from their buildings in order to (1) fund new infrastructure projects or (2) balance current budget shortfalls. Using sale-leasebacks to invest in additional infrastructure projects is more common than using the revenue to meet operating expenses.

We found that most public entities structure their sale-leaseback transactions quite differently than California's proposal. Specifically, in most sale-leasebacks the state or local government sells certificates of participation in the building to investors and remains responsible for all of the building's services and costs. The certificates of participation carry a specified interest rate and maturity date, and repayments to the certificate holders represent the government's "lease payments." The government retains the risk of ownership under this type of sale-leaseback, but the building returns to state ownership when the certificates are paid off at the maturity date. In this way, it is more like borrowing with the property serving as collateral. For example, Arizona recently sold certificates of participation on 14 buildings it owns with maturity dates ranging from three to 20 years and an average interest rate of 4.6 percent to raise approximately $735 million to help address its budget deficit.

Examples similar to California, in which ownership of the building is permanently transferred to the new owner, are less common. The benefit of permanent transfer in a sale-leaseback is that it results in a higher sale price, but at the cost of indefinite lease payments that do not result in any equity. We found limited use of this type of sale-leaseback by some local governments as well as the United States and Canadian federal governments.

Fiscal Considerations

One-Time Revenue

The most obvious benefit of the sale-leaseback transaction is the one-time revenue generated from selling the buildings. The sale proceeds would first go towards retiring the outstanding lease-revenue bonds associated with some of the buildings. After deducting a small amount to reimburse DGS and CBRE for their expenses in arranging the transaction, the remaining sale proceeds would be deposited in the state General Fund—reducing the need for expenditure reductions or revenue augmentations that would otherwise be needed to balance the state's budget.

Budget Revenue Estimate. In January, the Governor's 2010-11 budget proposal assumed net sale proceeds would provide $598 million for the General Fund over three years, with about half coming in 2010-11 and the remainder in the following two years. (This is slightly lower than earlier estimates of $660 million.) Upon learning that DGS intended to move forward with all of the property sales in the budget year, the administration testified that the roughly $300 million in sale proceeds originally scored as revenue in 2011-12 and 2012-13 should instead also be counted in 2010-11. As part of its actions in the 8th Extraordinary Session, the Legislature accepted this assumption. Consequently, the budget plan now assumes $598 million in 2010-11 revenue.

Wide Range of Revenue Possible. The Governor's revenue estimate for the sale-leaseback is a preliminary projection. A wide range of revenue is possible given the variables involved in the transaction and the uncertainty of how investors will respond to the state's offering. The main factor determining the amount potential buyers are willing to bid on the properties is the estimated income stream the buildings will provide to the buyer. The offering memorandum established the rental rates the state would pay and outlined expected operating costs for each building. The final bid price, however, will ultimately depend upon many factors including the bidding competition, perceptions of the buildings' conditions, the economic climate, and expected returns.

Sale Price Could Be Higher. Considering each of these factors, we believe the Governor's revenue estimate of $598 million represents the low end of what the state could receive from the sale-leaseback of the 11 properties. The Governor's revenue estimate assumes a sale price of approximately $1.7 billion. (The difference of $1.1 billion between the sale price and net revenue would pay off the outstanding debt on the buildings and cover the transaction's expenses.) Based upon the projected net operating income the buildings would generate as calculated in the offering memorandum, a sale price similar to the Governor's estimate would mean that potential buyers bid cautiously. Alternatively, under a more optimistic scenario, the sale price could reach $2.5 billion, with net proceeds to the state of $1.4 billion after paying off the outstanding bonds. The final bid will ultimately depend upon each bidder's independent assessment of the potential risk and cash flows associated with the sale-leaseback as well as the bidding competition. We would expect, however, that the sale price would fall within the range specified above and summarized in Figure 3. (Consistent with this expectation, the administration announced as we were going to press that it had received bids with amounts above the Governor's budget assumption.)

Increased Annual Costs

The main argument against pursuing a sale-leaseback on state office properties is that the

20 years to 50 years of lease payments under the sale-leaseback will likely cost more than the state would spend maintaining ownership of the buildings. Currently, the state covers all of the costs associated with the 11 office properties proposed for the sale-leaseback. These costs include debt service, utilities, building management, janitorial services, routine maintenance, special repairs, and security. As described in the box on page 11, DGS is proposing a modified gross lease for the sale-leaseback in which a single lease payment to the new owner would replace most of these costs. As shown in Figure 4, making lease payments at the market rents proposed in the offering memorandum would cost the state approximately $30 million more in 2010-11 than the status quo of maintaining state ownership of the buildings. This assumes DGS is able to rapidly implement the staff reductions and internal restructuring necessary for the transition from state to private ownership. If the layoff and restructuring process takes some time and the state continues to incur some of these costs even after the sale, the first-year costs of the sale-leaseback would exceed the estimated $30 million—potentially over $10 million.

In subsequent years, the state's cost of owning the buildings under the status quo would actually decrease over time as the various bonds on the facilities are retired. Some of these ownership savings would be offset by increasing costs for utilities, maintenance, special repairs, and renovations as the buildings age. As shown in Figure 5 (see next page), however, we expect the declining debt service payments to outweigh the increasing operating costs so that the overall cost to the state of owning the buildings would steadily decrease until the bonds are completely paid off in 2028-29. (See the box on page 13 for a more detailed description of how we estimated ongoing costs.)

On the other hand, costs under the sale-leaseback would steadily increase due to the increases in base rent every five years and the annual operating cost increases included in the proposed leases. As shown in Figure 5, therefore, the estimated difference between the

Figure 3

Estimated One-Time Revenue From Sale

(In Billions)

Scenario	Purchase Price	Net Proceeds
Governor's budget	$1.7	$0.6
More optimistic	2.5	1.4

Figure 4

2010-11 Costs Under State Ownership and the Sale-Leaseback

(In Millions)

State Ownership		Sale-Leaseback	
Debt service	$111.8	Lease payments	$198.4[a]
Operations and maintenance	54.7	Gas and electricity	12.7
Utilities	14.1	CalEMA operating costs	1.2
Special repairs	4.6	Sublease revenue	-0.9
Parking and lease revenue	-3.9		
Total Cost	**$181.3**	**Total Cost**	**$211.4**

[a] Assumes LAO more optimistic sale scenario, which affects the value of the proposed property tax credit.

CalEMA = California Emergency Management Agency.

cost of maintaining ownership and the cost of leasing the buildings would increase over time. Considering this in terms of the state budget, the difference between the two alternatives is quite clear. Maintaining ownership of the buildings would lead to decreasing costs over time, lending a small contribution toward lessening the state's structural budget deficit. Alternatively, the rising cost of leasing the facilities would lead to an increase in the state's structural problem. In the near term, however, the greater cost of leasing compared to owning would be fairly modest—averaging about $34 million annually over the first five years. However, the cost differential would increase to over $200 million annually in later years.

The Governor's 2010-11 budget proposal includes language allowing the Department of Finance to adjust budget amounts for rental costs associated with the sale-leaseback. Such adjustments would be necessary because appropriations scheduled to pay the debt service on the buildings, for example, would have to be redirected as lease payments to the new owners if the sale-leaseback transaction goes through. The Governor's budget assumes this adjustment would require $20 million to account for higher lease costs. Similar to the revenue projections, the Governor's rental cost projection of $20 million only assumed some of the buildings would sell in 2010-11. These costs would be higher if the state sold all of the properties in 2010-11 and leased them back at the market rents proposed in DGS' lease terms.

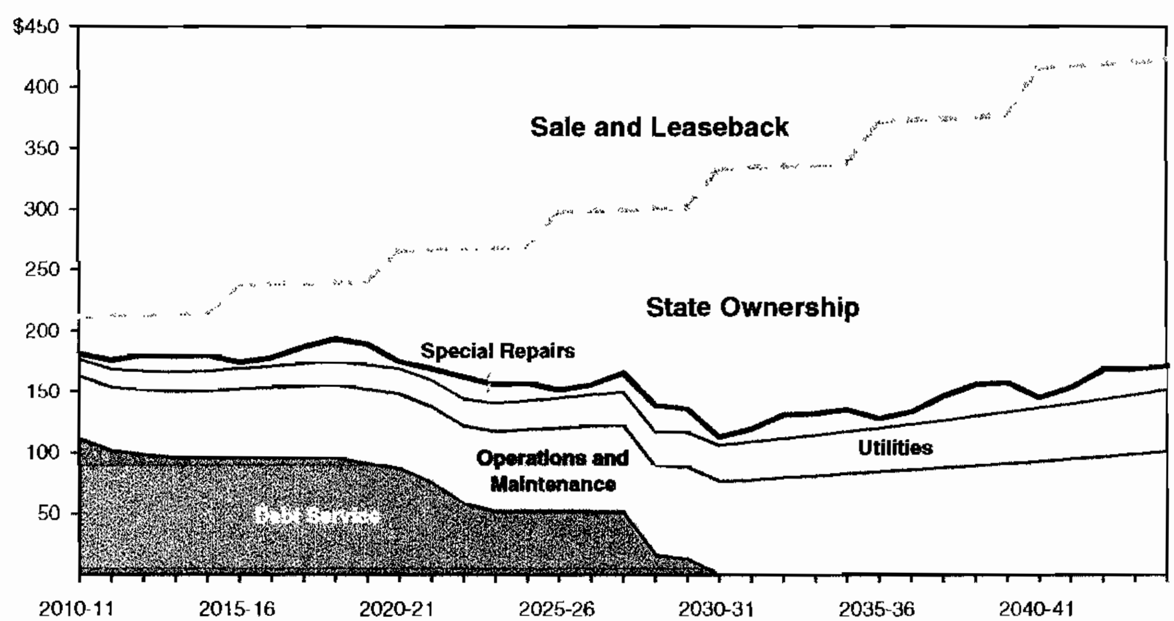
Other Factors

In the previous sections, we focused exclusively on the financial factors that we believe

Figure 5

State Ownership Costs Compared to Leaseback Costs

(In Millions)



PROPOSED LEASE TERMS

The long-term lease determines the income stream the new owners will receive from the buildings and therefore the price buyers are willing to pay. The lease terms are also essential in determining the costs of the sale-leaseback to the state over time. In the offering memorandum released to potential buyers on February 26, the Department of General Services (DGS) outlined the state's preferred lease terms. The following are the main components of the proposed leases for ten of the buildings:

- ***Type of Lease.*** Under a modified gross lease, the owner would be responsible for paying most building services including building management, janitorial services, maintenance, special repairs, insurance, and scheduled upgrades. The owner would pay utilities with the exception of gas and electricity costs, which the state would pay. The DGS believes this is in the state's best interests in order to take advantage of previous investments in energy efficiency. The state would also continue to provide security at those buildings with unique security needs.

- ***Lease Term.*** The initial lease would be for 20 years. After the initial term, the state would have the option to renew the lease under the same lease conditions for six additional terms of five years each—resulting in a total lease term of potentially 50 years.

- ***Rent Payments.*** Base rent payments would be set near current market rents for each property. The base rent would increase by 10 percent every five years.

- ***Operating Cost Escalator.*** On top of the base rent payments, the state would be responsible for paying annual changes in the owner's operating expenses. The operating costs would be set at a fixed amount when the buildings are purchased and adjusted each year by the change in the Consumer Price Index.

- ***Property Tax Credit.*** As a government, the state does not currently pay property taxes on state buildings. The base rent included in the offering memorandum assumes that property taxes would be assessed on the properties. Under Board of Equalization rules, however, lease terms (including options) over 35 years are considered the equivalent of ownership, meaning that the state would still be considered the owner of the buildings for tax purposes. The state would be provided an annual credit against its rent equal to the amount of taxes not assessed on the basis that market rents reflect property tax costs.

- ***Right of First Refusal.*** If the owner receives an offer from a third party for the purchase of one or more of the properties, the state would have an opportunity to purchase the property under the same terms as the third-party offer.

- ***Upgrades.*** The owner would repaint all interior surfaces every five years and replace all floor coverings every ten years.

- ***Subleasing.*** The state may sublease any portion of the space.

These lease terms would apply to all of the properties with the exception of the California Emergency Management Agency Headquarters. Due to the building's specialized purpose in responding to emergencies, DGS structured the proposed lease so that the state would maintain responsibility for all building services.

provide the most important information for deciding how to proceed with the sale-leaseback. In researching the sale-leaseback, however, we encountered other issues, which we address below.

Transfer of Risk and Increased Cost Predictability. Leasing the facilities would result in more budget certainty through fairly predictable lease payments while avoiding the risk of unexpected and large costs associated with special capital repairs and renovations. In other words, the risk of unexpected costs would shift to the new owner. The lease payments would not be completely predictable because in addition to the base rent, the state would be responsible for paying increases in operating costs which would fluctuate according to inflation (as measured by the Consumer Price Index).

In addition to the cost predictability, leasing the facilities should guarantee that the buildings receive adequate maintenance and investment. During budget shortfalls, the state has tended to reduce expenditures for maintenance projects. Under the sale-leaseback, the ongoing lease payments would be fixed obligations.

Elimination of Debt. A successful sale would eliminate debt that the state owes on eight of the facilities. As shown in Figure 6, the state has approximately $1 billion in outstanding lease-revenue bonds remaining on the buildings proposed for sale. As described above, the state would use the sale proceeds to pay off the remaining principal debt and therefore would not have to pay most of the $467 million in interest costs (approximately $65 million of the interest would still be paid to bondholders as compensation for retiring the bonds earlier than scheduled).

While lowering the state's debt is typically good policy, the benefit of eliminating the debt through a sale-leaseback transaction is illusionary. First, the avoided debt service would be immediately replaced with costlier rental payments to the new owners. Although the rental payments would not likely be considered debt in an accounting sense, they would still be an ongoing obligation of the state in future years.

Proponents have also suggested that eliminating the debt would improve the state's credit position. The state currently has approximately $73 billion in outstanding general obligation and

Figure 6

Debt on Proposed Sale-Leaseback Properties as of July 1, 2010

(In Millions)

Building	Remaining Principal	Remaining Interest Payments	Total Remaining Debt Service	Debt Retirement Date
Capitol Area East End Complex	$381.1	$197.7	$578.8	2027-28
Franchise Tax Board Complex	231.7	139.6	371.3	2029-30
Earl Warren and Hiram Johnson Buildings (Civic Center)	201.5	66.0	267.5	2021-22
Elihu Harris Building	101.1	40.3	141.4	2022-23
Junipero Serra State Building	36.4	10.8	47.2	2019-20
Attorney General Building	37.2	9.5	46.7	2019-20
Public Utilities Commission Building	17.8	1.8	19.6	2013-14
Ronald Reagan State Building	17.0	1.0	18.0	2010-11
Totals	**$1,023.8**	**$466.7**	**$1,490.5**	

lease-revenue bonds plus an additional $58 billion in authorized, but unissued bonds. Eliminating the comparably small bond debt on these eight buildings—less than 2 percent of the state's total debt—is unlikely to have a significant effect on the state's debt ratios. Additionally, the state's low credit rating is largely due to the state's structural budget deficit, which one-time solutions such as the sale-leaseback do not address.

Loss of Building Control. One concern raised with the sale-leaseback is that the state would no longer have control over each building's operation and condition. Assuming DGS and CBRE effectively incorporate minimum standards for the operation and condition of the buildings into the lease agreements, the state should be guaranteed a certain building standard even though it will no longer operate the buildings. Another concern was whether the state would maintain control over subleasing decisions. For example, daycare providers in the buildings were concerned that the new owners

Estimating the Cost of Maintaining State Ownership Of the Office Buildings

There are four main costs of owning and operating the state's office buildings: debt service, operations and maintenance, utilities, and special repairs. Only the debt-service payments are known with certainty. In forecasting the remaining costs, we attempted not to understate the potential costs and risk of the state continuing to own the buildings. Although not representing the worst-case scenario (we would not expect major failures in every building due to the diversity of the portfolio), we sought to provide significant allowances for major repairs and minor renovations. Our forecast starts with the Department of General Services' (DGS') estimated 2010-11 expenditures for operations and maintenance, utilities, and special repairs, and increases them each year by inflation. Then, in order to capture risk and potentially increasing costs as the buildings age, we did the following:

- We assumed additional capital reserves above DGS' estimates. To meet the need for capital repairs and tenant improvements, DGS sets aside funds each year into capital reserve accounts for each building. We increased the set aside by 50 percent.
- We assessed additional costs to each building every five years that increase as the buildings age. These costs are meant to capture potential costs for system failures, capital upgrades, and minor renovations.

Our cost estimate does not include the potential costs of major renovations, and also does not acknowledge the residual value of the buildings and land at the end of the forecast period. We assume these values would tend to offset each other.

The state also receives a small amount of revenue by charging for parking at some buildings and leasing space to daycare providers and retail (for example, credit unions and coffee shops). We assume these revenues increase at the rate of inflation.

could raise their rents or evict them. Under the proposed lease terms, however, the state would lease the entire building and continue to have authority over which space is subleased and at what price. For example, the state could continue to subsidize rental rates for daycare providers.

Opportunities for More Subleasing. In promotional materials, DGS has highlighted the limited subleasing capacity in state-owned buildings. In order to maintain the tax-exempt status of the buildings' financing, the amount of space that can be subleased to nonstate entities is limited. One purported benefit of the sale-leaseback is that under nonstate ownership, the state would have the added flexibility to sublease unneeded space to nonstate entities. In our view, the subleasing potential is minimal. Many of the buildings proposed for the sale-leaseback contain state government functions that are not likely to be eliminated or relocated so the availability of space for subleasing would be limited. In the event that downsizing did create some vacant space, the state would receive the same benefit by relocating other state agencies with shorter, less favorable leases into the sale-leaseback properties as it would from leasing the space to nonstate entities.

FISCAL ANALYSIS

If DGS finds a buyer and accepts an agreement on a sale-leaseback, the Legislature would have 30 days to review the transaction and determine if the state should enter into the agreement. As described above, the annual cost of owning the facilities would likely be much less than the cost of leasing the facilities over the long run. In evaluating the deal, the Legislature would need to consider whether the benefit of the one-time revenue from selling the facilities would be large enough to compensate for the higher costs in subsequent years.

As described above, we estimated the cost of maintaining state ownership of the office buildings and compared it to the cost of leasing the facilities under the terms proposed in the sale-leaseback. Over a 35-year period, we estimated the cost of leasing the facilities would be over $5 billion more than the cost of state ownership. As shown in Figure 7, these costs greatly exceed even the more optimistic estimate for sale revenue presented earlier. In present value terms (that is, adjusted for the principle that money available at the present time is worth more than money available in the future), the difference is considerably less. This is because the greatest costs are heavily discounted because they occur in the latter part of the 35-year period. Still, in present value terms, the leasing costs are greater than the one-time revenue. The sale-leaseback is projected to cost the state an additional $600 million to $1.5 billion.

A simple way to measure the cost in present value terms is to think of the sale-leaseback as a loan with interest—the state receives cash up front through the sale with the obligation to pay it back over time through lease payments. As shown in Figure 7, the state's effective interest rate would be between 7.1 percent and 14.3 percent. These interest rates are greater than those the state is currently paying on the buildings' outstanding lease-revenue bonds and greater than the effective interest rates on the state's recently issued general obligation bonds.

Single Portfolio Versus Individual Sales. The above calculations combine the revenue and costs of the state's entire portfolio of 11 buildings under the assumption that all of the buildings are sold. The bidders, however, are required to submit prices for each building and the legislation does not require DGS to sell every property. The DGS and the Legislature, therefore, could choose to analyze each building separately rather than as a single portfolio. Such an analysis could find that it is less costly to sell and lease back some buildings compared to others in the portfolio. For example, the state could receive a high bid on one building for which DGS currently has high operating costs and decide to sell that building while rejecting the remaining offers.

Results Sensitive to Various Factors. Our calculations were based upon a specific set of data and assumptions. If new information became available or the assumptions were changed, the analysis could be quite different. One of the larger uncertainties is estimating the cost of maintaining state ownership of the buildings due to the various risks and unknowns associated with building ownership. As described previously, we attempted to address this uncertainty by estimating these costs so as to not overstate the potential benefit of state ownership.

The number of years over which the sale-leaseback is analyzed is another parameter that effects the outcome of the analysis. For example, if the analysis only covered the initial lease term of 20 years, the sale-leaseback would appear more favorable because the growing costs in the later years would not be included. We chose 35 years for the evaluation period not only because it represents a reasonable useful life for the buildings in the portfolio but also because it is likely that the state would renew its leases on these buildings due to their role in providing government services, historic status, or proximity to other government buildings. For this reason, a shorter time frame would understate the cost of the leaseback in our view. For example, limiting the analysis to the initial 20-year term would not account for the significant costs in the following years of renewing the lease or leasing, buying, or building alternative space for these government functions.

Another factor open to different interpretations is the time value of money. Placing a larger emphasis on near-term revenues and costs, for instance, would make the sale-leaseback more attractive. The level to which the transaction's future costs should be discounted depends upon an individual's expectations about inflation, risk, and the value of future generations.

Figure 7

Estimated Revenue and Cost of Sale-Leaseback Compared to Status Quo

(In Billions)

Scenario	One-Time Revenue	Cost Differential Over 35 Years (Nominal)	Cost Differential Over 35 Years (Net Present Value)[a]	Cumulative Net Present Value of Sale-Leaseback	Effective Interest Rate
Governor's budget sale price	$0.6	$5.5	$2.1	-$1.5	14.3%
More optimistic sale price	1.4	5.2	1.9	-0.6	7.1

[a] Net present value with 5 percent discount rate.

RECOMMENDATION

The above calculations provide some understanding of the true underlying cost of the sale-leaseback by showing how the lease payments impact the state's budget beyond the budget year. The state originally invested in these buildings because it was determined that owning state office space would save money compared to leasing. Based on our analysis of the proposed sale-leaseback, this continues to be true as the cost of leasing back the buildings would exceed the sale revenue. As a result, we would normally not consider the sale-leaseback a reasonable budget solution since it would add to the structural deficit in order to address the current budget shortfall. Paying for the state's annual costs of running its programs with a one-time sale of critical state assets is poor fiscal policy.

In the current budget environment, however, the sale-leaseback represents one imperfect option among many for balancing the budget. In deciding whether to endorse the sale-leaseback, the Legislature will need to consider how its costs compare to other alternatives for addressing the state's budget shortfall, such as reducing expenditures and/or augmenting revenues. Given the array of difficult budget options before the Legislature, it would be difficult to specify how the sale-leaseback would compare. In general, however, we would encourage the Legislature to strongly consider other alternatives to the sale-leaseback. And, more specifically, we recommend the Legislature reject the sale-leaseback if the sales revenue is at the lower end of the range presented in this report—near the Governor's revenue estimate, for example—as the effective interest rate would be too high and make other options preferable.

NEXT STEPS

If the bids do not match the administration's expectations, DGS could decide to stop the sale-leaseback without seeking the Legislature's input, similar to DGS' actions for the sale of the Orange County Fairgrounds. If DGS decides to move forward with the sale, the department is required to provide details to the Legislature 30 days before completing the transaction. The 30-day reporting requirement was included to ensure the Legislature had an opportunity to examine the terms of the sale-leaseback and consider the matter again once all the information is available. With the bidding complete and terms agreed to, DGS will be able to provide the actual sale price and lease terms so that a more thorough analysis can be completed to show the actual benefits and costs of the sale-leaseback. The estimates in this report were based upon the lease terms proposed in the offering memorandum and assumptions about how buyers would react to the sale. With the actual numbers available, the Legislature can use this notification period to scrutinize the deal and stop the sale if it is unfavorable to the state.

EXHIBIT G

DGS
GENERAL SERVICES

State of California • Arnold Schwarzenegger, Governor
State and Consumer Services Agency
DEPARTMENT OF GENERAL SERVICES
Executive Office
707 Third Street • West Sacramento, CA 95605 • (916) 376-5000 • Fax (916) 376-5018 • www.dgs.ca.gov

October 11, 2010

The Honorable Denise Moreno Ducheny, Chair
Joint Legislative Budget Committee
1020 N Street, Room 553
Sacramento, CA 95814

Attn: Jody Martin, Principal Consultant

Dear Senator Ducheny:

Pursuant to Chapter 20, Statutes of 2009 (AB 22, Fourth Extraordinary Session, Evans), the Legislature authorized the sale and long-term lease of specified State-owned Buildings by adding Section 14670.13 to the Government Code. Governor Arnold Schwarzenegger signed this bill into law on July 28, 2009, recognizing the need to address the State's fiscal emergency he declared by proclamation on July 1, 2009, pursuant to the California Constitution.

Therefore, pursuant to Section 14670.13(e) of the Government Code and by virtue of this letter and all enclosures, I am notifying the chairs of the legislative fiscal committees of the terms and conditions of the transaction, including, but not limited to, the financial terms.

Based upon an extensive evaluation of all proposals and offers, the Department of General Services (DGS) is awarding the sale of all 11 properties to California First, LLC for $2.330 billion. The purchaser, California First, LLC agrees to the sale and long-term lease terms and conditions as specified in Attachment A.

I am also providing results of our economic analysis comparing the costs of the proposed sale and leaseback transaction to the continued status quo ownership of the buildings. Attachment B summarizes the economic analysis on the sale leaseback proposal. As requested by the Legislature, we have extended our economic analysis beyond the 20-year term of this transaction to a total of 50 years. We strongly caution, however, that economic analysis beyond 10 years in this industry is rare. Forecasting the cost drivers included in this analysis beyond 20 years becomes increasingly speculative and significantly diminishes the confidence of the analysis.

The economic analysis detail can be viewed at:
http://www.documents.dgs.ca.gov/resd/SaleLeasebackEconomicAnalysis.pdf

For clarification, among the properties to be sold is the entire Franchise Tax Board Building Complex located in the City of Sacramento (the "FTB Complex"). The FTB Complex is listed in the State Property Inventory, which is the official register of State-owned properties, as being located at "9645 Butterfield Way" and is therefore listed at that location in Section 14670.13. The FTB Complex includes the entire set of FTB facilities including Phase I, Phase II, Phase III, the Central Plant and Warehouse, and any other structures, grounds or improvements located on the property. The current United States Postal Service addresses for the FTB Complex are "9645 through 9696 Butterfield Way. The wording in Section 14670.13 to the FTB Complex located at 9645 Butterfield Way is based upon the State Property Inventory and not current U.S. Postal Service addresses.

Thank you for your continued interest and support in this important endeavor. Should you have any questions or need additional information, please contact Laura Zuniga, Deputy Secretary, Legislation, State and Consumer Services Agency at (916) 653-3111.

Sincerely,

Ronald L. Diedrich
Acting Director

Attachments: Attachment A – Terms and Conditions
Attachment B – Economic Analysis Summary

cc: See attached distribution list