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Terry Rich
Chief Executive Officer

MEMO

TO: Members of the House Government Oversight Committee and Senate Government Oversight Committee

FROM: Terry Rich and Mary Neubauer, Iowa Lottery

DATE: Feb. 3, 2014

RE: Background regarding Iowa Lottery Authority's plans to purchase property in Clive

In addition to the updates we've provided to your committees over the past year about our considerations surrounding the lottery's headquarters location, this memo provides additional background details about the project. Please also refer to the accompanying document, the Iowa Lottery Authority's legal notification regarding its intent to purchase property in Clive.

This morning, the Executive Council of Iowa approved plans for the Iowa Lottery Authority to purchase the property at 13001 University Ave. in Clive for \$5.35 million and short-term financing on a portion thereof. The transaction is designed to pro-actively manage the risk of a disruption in lottery operations that could compromise lottery sales, which average about \$1 million per day.

Today's Executive Council approval follows Jan. 29 approval by the Iowa Lottery Board of the property purchase. Under the proposal, the lottery will purchase the Clive property and re-locate its headquarters location there. The Clive building is currently vacant and in the possession of several banks.

The lottery has been reviewing its headquarters situation since late 2012, when its internal long-range planning led to the discovery of some maintenance issues at its current headquarters building at 2323 Grand Ave. in Des Moines. Since that time, the lottery's concern has been to minimize the risk of a disruption in its operations that could be caused by the headquarters maintenance issues.

Iowa Code Chapter 99G.21 gives the lottery the ability to acquire real and personal property by lease or purchase and to incur debt in its own name, however, any purchase of real property and any borrowing of more than \$1 million requires prior approval of the Executive Council of Iowa and notification to your committees.

The lottery is self-funded and the Lottery Board approved a total of \$7 million in the lottery's budgets for fiscal years 2014 and 2015 for a possible headquarters project (\$3.5 million in each year). Under the purchase proposal for the Clive building, the lottery would close on the property

on or about April 1, 2014, paying \$3 million of the purchase price in the current fiscal year. The lottery anticipates financing the remaining \$2.35 million of the purchase price along with interest on that amount at the time of closing. It would then pay the financed amount and any accrued interest at the beginning of FY 2015, within six months of the closing. However, it has the option of paying the entire purchase price in FY 2014 if its revenues allow for that.

The lottery consulted with a number of building and maintenance specialists in its property review and ultimately worked with the state of Iowa's property experts -- the General Services Enterprise Real Estate Team within the Iowa Department of Administrative Services -- to ensure an open and thorough process.

The DAS-GSE Real Estate Team evaluated the options of renovating the lottery's existing headquarters location in Des Moines; purchasing land and constructing a new building; and moving to an available existing property. The option identified as providing the lowest operational risk for the lottery and the best financial option for the state was for the lottery to move to a different existing building within the Des Moines metropolitan area.

Pages 3-5 of this memo provide a review of the Effective Occupancy Costs for the three possible property options. The effective occupancy cost is defined as the price for the lottery to operate at the particular site over a 10-year period, minus any property value at the end of that time. As the review shows, the purchase of the Clive property has a dramatically lower effective occupancy cost than do the other two options.

The DAS Real Estate Team handled all public input, notification and negotiations for the lottery project. DAS identified more than 20 potential properties and toured several of them before ultimately making an offer on the commercial property at 13001 University Ave. in Clive. The location had once been listed at \$7.9 million, but after aggressive negotiations, the lottery agreed to a purchase price of \$5.35 million as described above.

The Class A office building is currently unoccupied and in the possession of several different banks. It provides easy access to visitors from I-80/35 and I-235; is energy efficient with modern HVAC and lighting; and is practically turnkey in terms of the lottery's ability to relocate its headquarters there quickly, thus successfully managing the business risks associated with an emergency relocation or closure at its current headquarters building.

In addition to approving the purchase of the Clive property, the Iowa Lottery Board voted unanimously at its Jan. 29 meeting for the lottery to work with DAS to sell the lottery's current headquarters property in Des Moines. Any income that the lottery receives from the sale of 2323 Grand Ave. will help offset the costs of the Clive project and ultimately increase lottery transfers to the state General Fund.

The members of the Iowa Lottery Board are: Chairperson Mike Klappholz of Cedar Rapids, a retired police chief; Vice Chair Herman Richter, president of The Three Sons clothing store in Milford and a co-founder of the popular and mythical University of Okoboji; Mary Junge of Cedar Rapids, a CPA and practicing tax and estate-planning attorney; Deb Burnight, a certified professional facilitator and trainer from Sioux City; Matt McDermott of West Des Moines, an attorney at a Des Moines law firm; and State Treasurer Michael Fitzgerald, who serves on the Board as a nonvoting member.

Iowa Lottery Space Options -- January 22, 2014 (FINAL)

Renovate 2323 Grand	Leased Location	Proposed Building Purchase
Building -- 47,000 sf (all office)	Building -- 45,972 (all office)	Building -- 43,298 sf (all office)
Costs:	Costs:	Costs:
Renovation & Initial Relocation 1 \$7,848,750	Purchase Price \$0	Purchase Price \$5,350,000
Relocation Costs ³ \$0	Estimated Tenant Improvement Budget ^z \$1,249,300	Estimated TI Budget \$1,000,000 (Security, Generator, IT wiring)
Relocation back to 2323 \$16,500	Relocation Costs ³ \$50,000	Relocation Costs ³ \$50,000
Furnishings ⁴ \$203,500	Furnishings ⁴ \$203,500	Furnishings ⁴ \$203,500
Leasing Costs during renovation ⁵ \$240,000		
Initial Cost to Occupy \$8,308,750	Initial Cost to Occupy \$1,502,800	Initial Cost to Occupy \$6,603,500
Annual Operating Expenses 7 \$270,250	Annual Operating Expenses 7 \$897,975	Annual Operating Expenses 7 \$225,150
Operating Expenses (10 Years) \$2,702,500	Operating Expenses (10 Years) \$8,979,750	Operating Expenses (10 Years) \$2,251,496
Total Occupancy Cost (10 Years) \$11,011,250	Total Occupancy Cost (10 Years) \$10,482,550	Total Occupancy Cost (10 Years) \$8,854,996
Less Value of Property after 10 Years ⁸ \$3,900,000	Less Value of Property after 10 Years ⁸ \$0	Less Value of Property after 10 Years ⁸ \$6,000,000
Effective Occupancy Cost \$7,111,250	Effective Occupancy Cost \$10,482,550	Effective Occupancy Cost \$2,854,996

Assumptions:

Note 1: Renovation -- 2323 Grand

Architect's Estimate includes: parking lot, landscaping, mechanical, electrical, roof, windows, fire sprinkler, entrance, finishes, initial relocation)

Architect's Estimate (includes initial relocation)	\$6,600,000
Coordination Study/ARC Testing	\$100,000
Elevator Renovation	\$100,000
Asbestos Monitoring	\$25,000
Subtotal	\$6,825,000
Contingency (15% of costs above)	<u>\$1,023,750</u>
Total	\$7,848,750

Note 2: Tenant Improvement Budget -- Leased Location

Renovation (\$25/sf)	\$1,149,300
Generator	\$100,000
Total	\$1,249,300

Note 3: Relocation -- Used \$50,000 which was included in Architect' Analysis -- Approximately \$900/employee (\$600/emp for phone & internet wiring; \$300/emp for movement of desk contents)

Note 4: Furnishings -- \$3,700 per workstation for 55 employees

Note 5: Temporary Leased location-- 9 month occupancy
20,000 sf @ \$16.00/sf FSG

Note 6-- Effective Occupancy Cost

The analysis does not include any sales proceeds from the potential sale of 2323 Grand

Note 7-- Annual Operating Expenses

2323 Grand --- \$5.75/sf/year

Leased Location -- Rental Rate \$17.75/sf/year Modified Gross; Tenant pays \$1.00/sf for electric; Total Operating Cost \$18.75/sf/year

Leased Location -- Parking -- 60 parking spaces at City Parking Ramp -- Monthly rate of \$50/space

Proposed Building Purchase -- \$5.20/sf/year (10% increase over 2010-2011 Actual Operating Expenses)

Note 8 -- Value of Property

2323 Grand --- Appraisal value with Improvements after 10 years.

Leased Location -- No Value

Proposed Building Purchase -- Estimated Value of Building after 10 years

Expenses:	2323 Grand		Proposed Bldg		
	SF	Per SF	SF	Per SF	
Utilities					
Electricity					
Gas					
Water					Includes Irrigation & Sewer
Sewer					
Trash					
Subtotal	\$87,937.00	\$1.87	\$66,794.00	\$1.54	
Lawn Care					
Snow					
Subtotal	\$16,996.00	\$0.36	\$26,413.00	\$0.61	
Maintenance & Repairs					2323 Grand -- Stroh Proposed: HVAC, Electrical, Plumbing General, Painting , Parts & Supplies
Fire Prevention/Alarms					
Concrete/Parking					
Elevator					
Generator					
Subtotal	\$22,648.00	\$0.48	\$5,648.00	\$0.13	
Carpet Cleaning					
Pest Control					
Window Cleaning					
Subtotal	\$3,260.03	\$0.07	\$10,420.00	\$0.24	
Janitorial					Janitorial provided by ILOT Staff
Grand Total	\$174,641.03	\$3.72	\$204,815.00	\$4.73	
Assume \$2.00/sf for additional Maintenance		\$5.75	Assume \$.47 rise due to time (10%)	\$5.20	

Notes on Differences:

1. Lawn Care/Snow Removal -- Proposed building has more landscape and common area to be maintained -- (\$10,000/year higher)
2. Proposed building assumes increased carpet cleaning & window washing than currently being done at 2323 Grand (\$7,000/yr/higher)
3. Proposed building assumes janitorial is provided by ILOT staff member
4. Utilities -- The new building uses about 20% in utility costs (\$ 20,000/year lower)
5. Maintenance/Repairs -- 2323 Grand - \$3.41/sf/year; Proposed Building -- \$2.34/sf/year