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Terry E. Branstad · Governor
Kim Reynolds · Lt. Governor
Terry Rich · Chief Executive Officer

To: Members of the Iowa House Government Oversight Committee

**From: Terry Rich and Mary Neubauer
Iowa Lottery**

Date: April 28, 2015

Re: Lottery committee appearance on April 23

Thank you for meeting with us this past week so we could provide your committee with an update regarding lottery operations.

During the meeting, a committee member asked for further details regarding the lottery's headquarters relocation project here in the Des Moines area. I hope this document and the attached memo to the Government Oversight Committees from February 2014 will provide the information sought.

If you have further questions, please don't hesitate to reach out to us. We're happy to help.

The lottery has reported to the legislative Government Oversight Committees several times in recent years about its headquarters relocation project, which was precipitated by a 2012 analysis of the lottery's long-term budget needs. Part of that analysis included a review by the Iowa Department of Administrative Services (DAS) of major maintenance and improvement needs at the lottery's headquarters location at the time, 2323 Grand Ave. in Des Moines. The lottery had achieved savings through the years by purchasing the property, but the review revealed maintenance issues at the site that needed to be addressed.

Reviews by two separate engineering firms (MODUS in Des Moines and KJWW in Urbandale) concluded that in addition to other repair and replacement needs, the building's HVAC system was well beyond its life expectancy, with major parts for the system no longer produced.

Failure of the system would have forced the lottery to make an emergency replacement, displacing employees and possibly compromising lottery sales, which average nearly \$1 million per day.

Both engineering firms also concluded that the outdated design of the HVAC system was not compatible with modern equipment and necessitated a complete replacement, including asbestos abatement. Other major maintenance needs at the building over the next five to 10 years included roof replacement, installation of energy-efficient windows and elimination of a water-infiltration issue in the garage/storage area.

The review led to a 10-year pricing comparisons of three options:

- Renovation of the existing building
- Leasing of a location elsewhere
- Purchase of office space elsewhere.

That comparison document (*entitled "Iowa Lottery Space Options – January 22, 2014" and a part of the attached 2014 memo to the legislative Government Oversight Committees*) included figures that were referenced during our meeting with your committee. The figures were for the projected effective occupancy cost to the lottery over 10 years from the three different options – renovate; lease; and purchase. The purchase option had the lowest effective occupancy cost by far.

Based upon the findings of that review, the lottery ultimately purchased its current headquarters location at 13001 University Ave. in Clive, completing its move to the location on time and under budget. The lottery began operations in Clive on Dec. 30, 2014.

After negotiations, the lottery purchased the Clive location for \$5.35 million. Notification of the purchase was provided to the legislative Government Oversight Committees in February 2014 after approval by the state Executive Council and Iowa Lottery Board.

The property was purchased with existing lottery revenues from FY 2014 and FY 2015, and the lottery has still been able to meet and even exceed its annual proceeds projections to state causes.

The lottery budgeted \$7 million over two fiscal years to pay for the relocation project. At the end of fiscal year 2015, we estimate that those costs will be closer to \$6.8 million.

Des Moines Public Schools purchased the lottery's previous headquarters location on Grand Avenue in Des Moines for \$1.6 million, which resulted in about \$1.5 million in proceeds to the lottery after applicable fees. When the proceeds from that transaction are included, the lottery's final net purchase cost for its Clive location is about \$5.3 million.

The square footage of the Clive location is 43,298 square feet, or \$122/sq. ft. based upon the final net occupancy cost. It would have been extremely difficult if not impossible for commercial space to be constructed elsewhere for that price per square foot.

Des Moines Public Schools plan to utilize the Grand Avenue building for administrative offices, freeing up classroom space at a downtown school that had been dedicated to that purpose. The school district was able to replace the Grand Avenue building's HVAC system while the location was empty during the past few months and is moving employees into the space this spring.

The lottery believes that the Clive location is a good fit for its business needs and is proud to have acquired a valuable asset for the state of Iowa at a very competitive price. In addition, the transaction brought back into service a Class A office building that was unoccupied and in the possession of several banks at the time of the lottery's purchase offer.

Terry E. Branstad
Governor

Kim Reynolds
Lt. Governor



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					Flowers, irrigation repairs, fertilizer, etc.
Subtotal	\$16,996.00	\$0.36	\$26,413.00	\$0.61	
Maintenance & Repairs					
					2323 Grand -- Stroh Proposed: HVAC, Electrical, Plumbing General, Painting , Parts & Supplies
Subtotal	\$43,800.00	\$0.93	\$95,540.00	\$2.21	
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