

AGENDA ITEM

703 FEBRUARY 1 2016

DATE: February 1, 2016

TO: Members, Members, Board of Trustees

FROM: Leah Wilson, Chief Operating Officer

SUBJECT: Request for Resolution Authorizing the State Bar to Borrow Funds to Finance Tenant Improvements at 180 Howard Street

EXECUTIVE SUMMARY

This agenda item requests Board authorization for the State Bar to borrow up to \$10 million from Bank of America, to fund tenant improvements on three floors at the Bar's 180 Howard Street, San Francisco, headquarters building. The State Bar previously entered into a \$25.5 million real estate loan agreement with Bank of America for the purchase of 845 South Figueroa Street in Los Angeles. The additional \$10 million loan will be under substantially the same terms and conditions as the existing loan, except that it will be secured in part by a pledge of revenue, in lieu of a debt service reserve requirement, which will allow the entire \$10 million to be available for tenant improvements. The vacant floors, once renovated and leased to third-party tenants, have the potential to generate more than \$2.5 million in annual rental income. A cost benefit analysis based on an indicative taxable rate of 4.55 percent shows that this transaction will yield a return on investment in approximately five years.

BACKGROUND

The State Bar owns its office buildings at 845 South Figueroa Street in Los Angeles and 180 Howard Street in San Francisco. At both locations space not used by the State Bar is leased to third party tenants. At 180 Howard Street, three such floors are currently vacant – two due to the departure of previous long-term tenants, and one that was previously held in un-renovated condition for possible State Bar use or eventual lease to tenants. Before these floors can generate rental income, the State Bar must 1) bring them back to code-compliant "warm shell" condition (demolition of old tenant improvements; upgrade to landlord's portion of HVAC, electrical and life safety systems; renovation of restrooms and common areas); 2) pay real estate broker commissions to secure tenants; and 3) provide tenant improvement allowances to tenants. [References in this agenda item to "tenant improvements" include all three cost categories.]

At the July 2015 Planning & Budget Committee meeting, staff made a budget presentation informing the Committee that the State Bar had sufficient funds for required capital improvements (upgrades to major building systems) at 180 Howard Street, and would require a budget amendment to allocate the funds, but could not finance tenant improvements to vacant

floors without creating a deficit in the General Fund. The Committee directed staff to conduct a further analysis of costs and benefits, and to evaluate the feasibility of securing an additional real estate loan to finance the tenant improvements.

At the September 2015 Planning & Budget Committee meeting, staff presented additional background information about capital improvements in support of the budget amendment; provided a cost-benefit analysis of financing the tenant improvements with a bank loan; provided an update on its ongoing discussions with several financial institutions related to the feasibility of a loan; and informed the Committee that a loan application package to Bank of America was being prepared.

At the October 2015 Board of Trustees meeting, the Board approved a 2015 budget amendment that included an additional allocation of funds for capital improvements. Staff reported that the Bar had received verbal notification that Bank of America would approve for a loan to finance the tenant improvements, the terms and conditions of which were to be evaluated. The results of that evaluation are presented here.

DISCUSSION

State Bar staff engaged in several discussions with Bank of America, with whom it had entered into a loan agreement for the purchase of 845 South Figueroa Street in Los Angeles, to assess the feasibility of an additional loan for the 180 Howard Street tenant improvements. As a result of these discussions, Bank of America agreed to accept a loan application package, which was submitted by staff on October 2, 2015. To increase the likelihood of approval, the application package asked for consideration of two alternatives: a \$6.6 million loan to fund tenant improvements on only two floors, and an additional \$3.1 million loan to simultaneously fund the improvements on a third floor.

On October 16, 2015, Bank of America submitted a proposal for a Commercial Real Estate Term loan of up to \$10 million, for ten-year term, under substantially the same terms and conditions as the existing loan for 845 South Figueroa Street. This included the same terms for securing the loan: 1) via a Deed of Trust encumbering 180 Howard Street, and 2) with a debt service reserve account, whereby the State Bar would keep an amount equal to two times the annual debt service in a reserve account at Bank of America, along with substantially similar prepayment penalties.

Pursuant to the October terms, the debt reserve requirement would have totaled approximately \$2.5 million, meaning that, in effect, only \$7.5 million would be available for needed tenant improvement projects. During further negotiations on this topic, Bank of America agreed to eliminate the debt service reserve requirement if the State Bar could instead make a pledge of revenue to secure the loan. Business and Professions Code section 6001 expressly permits such a pledge. Bank of America has therefore agreed to modify its terms and conditions and eliminate the debt service reserve requirement. Therefore, the full \$10 million will be available to fund the tenant improvements on all three vacant floors.

In addition to eliminating the debt service reserve requirement, Bank of America agreed to revisit the issue of prepayment penalties, providing for options to call at par at any time following the fifth or seventh anniversary of the funding date; the five year call option premium totals 16 basis points, the seven year option, eight. Preliminary analysis suggests that it would be beneficial for the Bar to exercise one of the early call options.

Upon approval of this resolution, planning would resume immediately. Warm shell renovations, including planning, mobilization and implementation, would be scheduled for approximately February 1 – September 30, 2016. Leasing efforts would occur concurrently, in the hopes of having leases in place by October 1, 2016, tenant build-outs completed by March 30, 2017, and rent revenue commencing in April 2017. Based on this schedule, the cost-benefit analysis prepared by the Office of Finance shows a return on investment commencing in January 2021. This proposed schedule, as well as all financial costs and benefits, represent our best estimates based on current market conditions and other known factors.

The Office of the General Counsel has further reviewed the summary of terms and conditions of the proposed loan, which contemplate entering into an agreement side-by-side with the existing (or to be amended) loan agreement for 845 South Figueroa Street, on substantially the same terms and conditions as that existing agreement. To date, there have been no known legal issues arising out of that agreement that would give rise to any concerns moving forward.

Staff evaluation of loan feasibility included discussions with other financial institutions. During preliminary discussions, however, those other institutions did not think a loan was feasible; only Bank of America encouraged staff to submit a loan application package. Upon receipt of Bank of America's proposal, staff engaged in further due diligence, reaching out to those institutions again. Although additional discussions took place, these institutions were not able to provide terms and conditions acceptable enough to warrant further negotiation.

FISCAL/PERSONNEL IMPACT

If this resolution is adopted, the State Bar will incur \$10 million of debt in the form of a commercial real estate term loan.

BOARD BOOK IMPACT

None

PROPOSED BOARD OF TRUSTEES RESOLUTION:

If the Board approves this item, staff recommends that the Board of Trustees adopt the following resolution:

The Board of Trustees hereby adopts the following resolution:

RESOLVED, the State Bar is authorized to borrow up to \$10,000,000 (the "Loan") from Bank of America, N.A. (the "Bank of America") solely for the purpose of paying costs associated with tenant improvements at 180 Howard Street, and to secure the Loan with a) a Deed of Trust encumbering the State Bar's property located at 180 Howard Street, San Francisco, CA and b) a pledge of State Bar revenue, all as permitted by Section 6001 of the California Business and Professions Code. The Loan will be evidenced by a Term Note, the interest on which is not included in gross income of the owner thereof for federal income tax purposes and is exempt from taxation by the State of California; and it is

FURTHER RESOLVED, the Chief Executive Officer Elizabeth Parker and the Chief Operating Officer Leah Wilson are each authorized and directed to negotiate, execute, and deliver the Loan Agreement, Term Note and Deed of Trust, and any ancillary documents required by the Bank or bond counsel to the State Bar (collectively "Loan Documents") for the Loan, including making a decision regarding early call premium options, provided that the principal amount of the Loan may not exceed \$10,000,000; and it is

FURTHER RESOLVED, the Chief Executive Officer and the Chief Operating Officer are authorized and directed, for and in the name and on behalf of the State Bar, to do any and all things and take any and all actions and execute any and all certificates, agreements and other documents which they, or any of them, each may deem necessary or advisable in order to consummate the lawful execution and delivery of the Loan Documents in accordance with, and related to the transactions contemplated by, this Resolution.