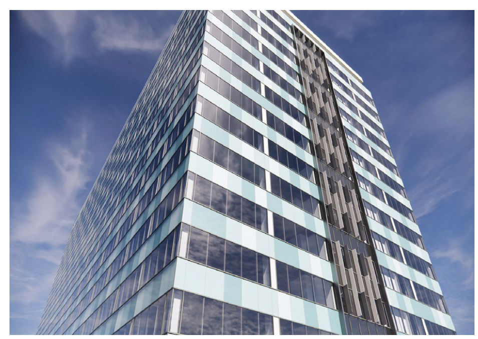
DGS CALIFORNIA DEPARTMENT OF GENERAL SERVICES

GOVERNMENT OPERATIONS AGENCY



2025

Department of General Services

REAL ESTATE PORTFOLIO PLAN

Real Estate Services Division

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Real Estate Portfolio Plan – Executive Summary

The Department of General Services' Real Estate Portfolio Plan (Plan) is prepared by the Real Estate Services Division (RESD) and updated bi-annually. The purpose of the Plan is to provide a) a framework for the evaluation of DGS' inventory of office buildings, and b) a long-term plan for those buildings. In creating this Plan, RESD is effectively answering the question, "where does it make financial sense to own a state office building?"

Historically, the answer to that question was assumed to be "everywhere." This was because long-term ownership of an asset was presumed to be more cost effective than continuous leasing costs. In 2018, given the age and condition of DGS' inventory of buildings, that assumption was challenged. RESD compared the costs to renovate a building to new condition (utilizing lease-revenue bond financing) with the costs to lease space over the life of that bond and determined that there were locations where leasing was more cost effective.

Since 2020 and the advent of telework, RESD updated its analysis to incorporate potential savings due to office consolidations. RESD has further refined its model to reflect post-pandemic costs of construction, as well as current interest rates. More recently, RESD's analysis, as is described further, accounts for a variety of potential telework scenarios to ensure that ownership decisions are not made along narrow assumptions about long-term utilization of telework.

In summary, this updated analysis finds that it is *generally* more cost effective, over a 30-year period, to move to commercially leased spaces. This finding is market-specific, and subject to change as overall market conditions (ex: interest rates) change. For the foreseeable future however, given the recent impacts to the commercial office, the state would benefit from divestiture of specific assets.

- For DGS buildings **outside of Sacramento**, the cost-effectiveness of divestment is further affirmed low utilization rates, building deficiencies, the sharp increase in the cost of construction, and continued favorable terms for commercial rents. **While some buildings should be retained, especially in higher-rent markets, divestment is generally recommended**.

- For DGS' **Sacramento** portfolio, this results in recommending a **pause** in the completion of its renovation program in Sacramento and a **limited** divestment of office space. This limited divestment is due to the specific market conditions in Sacramento, the volume of state-owned space, the need to account for potential larger returns to the office, and other factors. RESD has accounted for potential scenarios in its recommendations (reflected in buildings listed as "retain and monitor").

Real Estate Planning Concepts and Principles

Operational Efficiency

- To generate operational and programmatic efficiencies, DGS will consolidate departmental space and co-locate departments within the same agencies and/or similar functions between departments.
- DGS will use more standardized office configurations to minimize tenant improvement costs and allow for the greatest flexibility when filling space.
- To avoid disruption and minimize costs, DGS will strive to minimize the number of moves a department must make.
- DGS will recognize that the public will increasingly expect the state to provide services electronically. Accordingly, DGS will work with client agencies to ensure that hybrid continues to be incorporated into all planning/projects.

Cost Effectiveness

- As DGS' portfolio spans multiple markets, DGS will continue to utilize strategies that take localized market conditions and trends into account.
- DGS will ensure that the recommendations address its deficient infrastructure. Without intervention, these buildings will continue to degrade and will cost taxpayers more to address later than through a proactive approach.
- DGS will account for fluid variables, including market conditions, building conditions, and tenant program need. As these are subject to change, DGS shall update these assumptions and data used in the Plan as market conditions change.

Equity, Sustainability, and Responsible Development

- DGS will, when feasible, construct new buildings in proximity to public transit and look to activate underserved areas through the inclusion of building amenities (such as retail) that support the area. For excess state buildings, DGS will prioritize housing, and other state reuses.
- DGS will incorporate climate change risks into design decisions and will design new construction and renovation projects towards achieving Zero-Net Carbon.
- DGS will work with client agencies on locating office space in ways that provide equal access to state services by all Californians and minimizes disruption to vital governmental services.
- DGS will evaluate options, and execution strategies, recognizing that this Plan will have an impact on state employees – both the tenants, as well as those DGS staff who maintain them.

Plan History and Important Considerations

History of the Portfolio Plan

- In 2015, DGS undertook a planning study of its portfolio of buildings. Using third-party consultants, DGS completed Facility Condition Assessments (FCA) of each building under the jurisdiction of the department. While these FCAs were not intended to be comprehensive infrastructure reviews, they did provide higher level assessments of building deficiencies and served as a basis for comparing those deficiencies across buildings.

- In 2016, DGS published a Ten-Year Sequencing Plan that proposed a strategy for addressing its aging portfolio. The Sequencing Plan recommended constructing three new state office buildings to expand the portfolio and accommodate the projected future growth. Doing so would allow DGS to relocate tenants from some of the most deficient buildings in the area, and then renovate the subsequently vacant building. This would continue, in a controlled sequence, until the portfolio's useful life was extended.

- In 2019, DGS addressed its portfolio outside of Sacramento. DGS conducted an evaluation of the appropriateness of continued ownership of DGS-managed buildings and established the groundwork for the portfolio plan with respect to state ownership of office space outside of Sacramento.[1]

- In 2021, DGS updated its analyses of its building portfolio, including progress made to date. However, due to the advent of widespread telework, including the effect that telework had the potential to have on the commercial office sector, DGS delayed any further analysis until the publication of this Plan.

Successful Implementation of Prior Recommendations

To date, RESD has been successful in implementing the recommendations from prior versions of the Plan. In summary:

- **RESD has completed construction of all planned new state office buildings**. Specifically, the May Lee State Office Complex (formerly the Richards Blvd Office Complex); the Clifford L. Allenby Building; the New Natural Resources Headquarters Building; and the 10th/O Office Building (Swing Space).

- **RESD is finalizing completion of the most important three renovation projects**. Specifically, the Gregory Bateson Building (Spring 2025); the Jessie Unruh Building (Summer 2025); and the Resources Building (Fall 2025).

- **RESD has begun the divestment of selected state office buildings**. Specifically, the San Diego State Office Building (awarded for affordable housing); the Fresno Water Resources Building (awarded for affordable housing); the Alfred E. Alquist Office Building (transferred to San Jose State University for demolition and redevelopment as faculty/staff housing); the Redding State Office Building (transferred to the Department of Motor Vehicles to accommodate an area consolidation for the department); the EDD Headquarters and Solar Buildings (to be vacated in 2025); the State Personnel Building (to be vacated in 2025); and the Stockton State Office Building (to be vacated in 2025).

Implementation and Use of Hybrid Work

- In June 2024, the state transitioned to a hybrid structure to promote greater collaboration and cohesion (hybrid Model). While a hybrid model with respect to telework is any combination of in-office and remote work, the June 2024 model authorized up to three days of remote work each week.

- For the new buildings in construction and for the planned renovations, DGS had anticipated such a shift and designed its buildings to be hybrid-enabled.

- However, each department is responsible for its own operations, and because those operational needs drive space requirements, the long-term space needs of state departments will always require active input from departments.

Hybrid and Space

While the use of hybrid may reduce the need for square footage at a given location, it is not always easy to give up space or to merge offices. IT considerations, lease terms, building exiting limitations, and information security/confidentiality can make realizing space savings due to telework more complicated than it would appear.

- As such, it is impossible to account for space needs relative to hybrid in a way that is not program specific. For the purposes of analysis, it was assumed that three days of remote work would translate into an approximately 30 percent savings in overall space needs. However, RESD's analysis does not rely on any variation of hybrid work.

- The state's adoption of hybrid work was consistent with the private sector, and the state has seen hybrid have an impact on the overall commercial office space market in California.

    - The typology of commercial office space is shifting. As companies implement their own forms of hybrid work, to make the transition back to the office more attractive, there has been a shift to smaller, higher-quality spaces with more amenities, like on-site fitness centers, cafeterias, and outdoor workspaces.

    - There is an oversupply of traditional office space in some markets, and high interest rates limit options. While owners (retail and traditional) are exploring ways to transform their properties, including conversion to affordable housing or adding a centralized entertainment offering to encourage foot traffic to surrounding retail locations, property owners are generally offering prospective tenants with more favorable leasing terms.

Summary of Recommendations by Office Building

Retain and Maintain

The following buildings are recommended to remain in DGS' portfolio of buildings. These buildings, for a variety of reasons, can be maintained without the need for a significant renovation (though some will require funding to address specific deficiencies or otherwise be refreshed).

1. Clifford L. Allenby Building (Sacramento)
2. New Natural Resources Headquarters Building (Sacramento)
3. 10th/O Office Building – "Swing Space" (Sacramento)
4. May Lee State Office Complex (Sacramento)
5. Gregory Bateson Building (Sacramento)
6. Jesse Unruh Building (Sacramento)
7. Resources Building (Sacramento)
8. Stanley Mosk Library and Courts Building (Sacramento)
9. Cal EPA Headquarters Building (Sacramento)
10. Rehabilitation Building (Sacramento)
11. East End Complex, Capitol Avenue, Blocks 171-174 (Sacramento)
12. East End Building, N Street, Block 225 (Sacramento)
13. Agriculture Building (Sacramento)
14. Paul Bonderson Building (Sacramento)
15. EDD Subterranean Building (Sacramento)

Retain and Renovate

The following buildings are recommended to be retained in DGS' portfolio. Reasons for this include historicity, the potential for special use (ex: Blue Anchor), or the continued need for a state office building in a historically high-rent market. However, the age and condition of these buildings are such that their long-term, continued, successful operation is conditioned upon undergoing significant renovations.

1. Blue Anchor Building (Sacramento)
2. Attorney General Building (Sacramento)
3. Ronald M. George State Office Complex (San Francisco)

Retain and Monitor

The following buildings should be categorized as either “Renovate” or “Divest,” depending upon the space needs of the state’s workforce in the future.

1. Franchise Tax Board Campus (Sacramento)
2. Department of Justice Building (Sacramento)
3. Building and Grounds Headquarters (Sacramento)
4. Office Building 8 (Sacramento)
5. Office Building 9 (Sacramento)
6. March Fong Eu Secretary of State Building (Sacramento)
7. Library and Courts Annex (Sacramento)
8. Warren-Alquist State Energy Building (Sacramento)
9. Elihu M. Harris Building (Oakland)
10. Governor Edmund G. “Pat” Brown Building (San Francisco)
11. Junipero Serra Office Building (Los Angeles)
12. Ronald Reagan State Building (Los Angeles)

Divest (State Reuse, Housing, Sale)

The following buildings are recommended to be removed from DGS’ inventory. These buildings should be prioritized for state agency reuse (non-office) or as affordable housing sites. If those options were not feasible, then they should be declared surplus and sold. Some of these buildings are already in the process of disposal.

1. EDD Headquarters Building (Sacramento)
2. EDD Solar Building (Sacramento)
3. State Personnel Building (Sacramento)
4. 450 N Street Building (Sacramento)
5. Red Bluff State Building (Red Bluff)
6. Hugh Burns State Building (Fresno)
7. Justice Joseph A. Rattigan Building (Santa Rosa)
8. Mission Valley State Building (San Diego)
9. California Tower (Riverside)
10. Van Nuys State Building (Van Nuys)

Divest (Transfer to Another State Agency)

There are three buildings that are only temporarily in DGS’ jurisdiction. These buildings must be maintained prior to transferring to the client agencies for which they were constructed.

1. Leo J. Trombatore Building, Caltrans District 3 (Marysville)
2. Wadie P. Deddeh State Office Building, Caltrans District 11 (San Diego)
3. California Office of Emergency Services Headquarters (Sacramento)

“Deferred Maintenance,” Renovations, and Rental Rates

What About Deferred Maintenance?

The term “deferred maintenance’ is commonly misused. Importantly, “deferred maintenance” is **not** an omnibus term that refers to all work needed in a building. More technically, deferred maintenance refers to work needed in a building that is the **result of regular maintenance having not occurred**. With this definition in mind, there are four categories of building work that are often, mistakenly, rolled into the concept of deferred maintenance:

1. **Discretionary Aesthetic Changes** – this includes furniture refreshes (which are the responsibility of tenants), repainting of entire suites, etc.

2. **Code Compliance Alternations/Improvements** – this includes any work to alter or improve building systems to bring up to current code, either triggered by other work in the building or as a discretionary choice on the part of the owner.

3. **Building Infrastructure Failures** – examples under this category include an air handler ceasing to function halfway through its useful life and manufacturer defects that did not manifest until after the warranty period.

4. **End of Life Replacement** – this category is perhaps the most misconstrued with deferred maintenance. All building systems have an expected useful life, a useful life which can be positively impacted by regular maintenance, or negatively impacted by its lack. However, at some point, all building systems will fail and need to be replaced. When this occurs, while a lack of maintenance may have contributed to the *timing*, replacement of end-of-life equipment is not deferred maintenance.

Critically, RESD notes that the age and condition of DGS inventory of buildings is such that a great many of the buildings are either experiencing end of life related failures or will begin to shortly. As such, while increasing the Facility Management Division’s deferred maintenance budget is important, especially for those buildings in which the systems are midway through their useful life, an increase in that budget will not address infrastructure deficiencies in the portfolio. **Necessarily, for those buildings that will retained, it should be expected that some will require full building renovations.**

Revisiting Rental Rates

At present, DGS rental rates for its office buildings based upon the cost to generally maintain them. A modest deferred maintenance budget is included in that, but there are no rates-based funds to address building infrastructure failures, end of life replacements, code compliance alterations/improvements, or discretionary refreshes.

It has been suggested that DGS should consider including in its rental rates all necessary costs to ensure that DGS buildings reflect Class A office space. If DGS were to do so, the rental rates would rise dramatically. The full cost of a building renovation in 2024 equates to approximately $700 per square foot (SF), though that number will vary across projects. For the Mission Valley Office Building, for example, that would translate into $175,000,000 to renovate that 250,000 SF building. That funding would either need to be raised prior to beginning work (and so, charged to tenants over a period of time) or the construction project would need to be financed. If DGS were to bill tenants in advance of the project over five years, it would have to increase the rental rate by $13 per foot (currently, $3.43) – more, actually, as the building is not currently fully occupied. If that amount were instead financed, and then paid back in arrears over 25 years, it would add approximately $5 per foot. Either way, compared to the rental market in Mission Valley ($4.10 per foot), this would be untenable for those state agencies in the building.

For new or newly renovated buildings, there are no building infrastructure failures, end of life replacements, code compliance alterations/improvements, or discretionary refreshes needed. However, rental rates would need to be increased to ensure that funding was available when those did become necessary. Given that most building systems have a useful life of 15-30 years, that would reduce the cost per foot increase considerably. However, in the Mission Valley example (assuming a 30-year period), that would still net a $2.25 per foot increase (actually, closer to $4-$5 as a renovation in 2054 would be considerably more expensive due to inflation).

Ultimately, incorporating all building needs into the rental rates prove to be deeply impractical. However, RESD does recommend revisiting DGS' rental rate structure, albeit in a few years. DGS' portfolio has undergone a significant refresh already, both with recent renovations and with buildings removed from the department's portfolio. This refresh, coupled with the analysis in this Plan indicating which buildings are cost-effective to retain, provides a significant step forward in allowing for the reexamination of the rental rates across the inventory.

That said, RESD recommends advancing on the disposal of the buildings listed in this Plan before modifying rental rates.

Portfolio Plan Analysis – Ownership vs. Lease

Approach, Assumptions, and Variables

In order to analyze whether it is in the state's best interest to continue to own the current buildings in its portfolio, and given some of the unknowns noted previously, RESD evaluated the long-term value of continuing to own state buildings compared to long-term leases under a variety of scenarios, assumptions, variables. These include:

1. Two baseline reductions in space needs for current and proposed building tenants (no reduction from telework and a 30 percent reduction).
    a. **Note:** other reductions were assumed to test the thresholds of the cost-effectiveness of ownership vs. leases.
2. 7 percent interest rate for bond-financed renovations, assuming a 25-year term.
3. A standard rate for DGS to maintain the state-owned building, adjusted annually through an escalation factor.
    a. **Note:** presently, DGS rates vary per building: they historically have not.
4. An annual escalation factor for leased space rental rates in keeping with current lease standards.
5. A standard rate for one-time moving and building renovation costs.
6. Tailored assumptions on rental rates for leased spaces. These lease rates were regionally-based, utilizing rental rates offered at available commercial buildings in the area. These rates assumed initial and future tenant improvement costs, amortized over the firm term of the lease and repeating at each lease renewal.
    a. **Note:** it is not common to replace furniture ever eight years. This highly conservative approach inflates leased costs.
    b. **Note:** by conducting regional searches, RESD was able to confirm whether there was sufficient space in the area to allow for a move to occur at all.
7. Swing space rental rates for existing building tenants. RESD generally assumed that existing tenants would return to the building post-renovation and would need very short-term leases with some tenant-paid improvements that would be amortized over the short term.
8. Lack of long-term DGS ownership. Buildings that are only temporarily in DGS' jurisdiction were excluded from the analysis.

<u>Alternatives/Threshold Analysis</u>

With these variables in mind, RESD created an automated spreadsheet for each building that allows for these variables to be adjusted. These spreadsheets were populated with these **base assumptions** to determine the **base analysis** of whether it was more cost effective to own a given building than to transition the tenants into leased spaces. From there, for buildings in which it was more cost effective to lease, RESD adjusted variables to determine what the threshold would be for ownership to be the preferred option.

This **threshold analysis** was intended provide a sort of "check" on the recommendations. If, for example, a renovation did not pencil out at 7 percent interest, but it did at 6.5 percent, then it would be simply a matter of timing the renovation correctly. **However, if ownership as only cost effective under unrealistic scenarios, then disposing of the building is the right course of action**.

<u>Timeframe of Comparison, Additional Costs, and Tenant Financial Impacts</u>

It is of critical importance to note that the costs to own and lease were compared over a 30-year period (and 25 years of debt service). This is a reasonable approach as the useful life of many building systems/components are between 15-30 years. As such, at the end of that period, while another renovation would not strictly be required, the buildings will be incurring additional expenses beyond the base costs to maintain/operate. Going beyond that duration would require adding costs to the building (somewhat speculatively), which RESD is avoiding for the purposes of this analysis.

It is also important to note that the debt service, as described previously, adds a considerable amount to the cost equation. **Accordingly, as this amount is retired, the costs to own drop considerably. In areas in which the commercial market rents are higher, the costs to own will invariably be less expensive than leasing <u>at that point</u>.** This may indicate that, along a long enough period, that ownership will eclipse leasing. However, it is imperative to note that another renovation would be required at some point in the then-near future, and thus the cycle (and comparisons) will eventually repeat.

Finally, it is also critical to note that this analysis reviewed the total costs of ownership to the State of California, not to individual tenant departments. Moving to lease space, on the whole, may be the best option for the spending of taxpayer dollars, but it could – in the short term – increase the costs to individual tenants. For example, if DGS charges $3.50 per foot in Van Nuys, and the commercial lease rate is $4.05, moving to leased space will cost more for the tenants in the near term, even if it costs less over a 30-year term.

<u>Hidden Costs to Restack Office Buildings</u>

Importantly, it may be assumed that the state could realize savings due to the utilization of hybrid by simply adjusting state agency spaces to reflect telework in state-owned buildings and backfilling that vacated space with departments in leases (thereby saving those leased costs). Therefore, it is important to note that restacking office older office buildings will generally trigger a number of additional costs. These costs can include:

1. Creating a physical separation between the existing tenants and the new. This includes potentially moving walls, or the erection of new walls, as well as non-physical separators, such as added security systems and IT/Telecom systems.

2. Adjusting the office space to meet the needs of both the current and new tenants. Moving to a hybrid environment is most effective in a building with higher ratios of enclosed spaces (offices, huddle rooms, conference rooms, etc.). Reducing footprints generally necessitates adding such rooms.

3. Modifying building systems. The erection/moving of walls and creation of new enclosed spaces will necessitate adjustments to fire/life safety systems (ex: sprinkler head placements), HVAC ducting, etc. Modified spaces will need to brought to current code (ex: accessibility standards), and may trigger other, building-wide upgrades (depending upon a variety of factors, including building condition).

4. While not necessarily strictly required, restacking of older buildings should include a “refresh” of the office space. This would include new carpet and baseboards, fresh paint, and new modular systems office furniture. Importantly, the cost alone for this item is approximately $134 per foot in 2024.

This consideration of the hidden costs to restack office buildings is critical to understanding why portfolio management is a long-term planning effort. As restacking plans are developed (which themselves have a cost) for a given building, code analyses performed, designs produced, etc., there may only be a marginal increase to renovate the building entirely. Worse, departments might spend the time and money planning for a restack in a building that would need to be renovated anyway in the near-to-medium term.

Given that renovations while occupied are (very) **highly** inadvisable, and that the design, permitting, and construction necessary for a restacking can itself take several years, patient, thoughtful planning is warranted.

Ownership vs. Lease – Building/Regional Explanations

Sacramento Office Buildings

State office needs in Sacramento are complicated and unique:

1. The majority of DGS' buildings are clustered in the downtown area (specifically in or near the Capitol Area District).

2. While the majority of state buildings outside of Sacramento are regional or field offices, Sacramento buildings are dominated by headquarters offices for state agencies.

3. Not only are DGS' newly constructed or renovated buildings all in Sacramento, but Sacramento is also the home to buildings that were renovated or refurbished in the last 15-20 years.

4. Many of the buildings in DGS' inventory in Sacramento are either historic or qualify as such.

In evaluating DGS' Sacramento portfolio, RESD notes that the economic analysis will generally be the same for each building. This is due to a number of factors, including:

1. The Sacramento commercial office market does vary from submarket to submarket, but it is a reasonably inexpensive market in general.

2. While the state leases a significant amount of commercial office space in the Greater Sacramento Area, many of those leases are in submarkets where the cost per square foot is low. This limits the number of high value leases to vacate and consolidate into state office buildings.

3. DGS' work (since 2016) to modernize its portfolio has already resulted in a decrease in some of those high value leases.

4. DGS rental rates are not materially different from market rates in the Sacramento area on average. This means that consolidation from one building into another will also generally not result in any significant shift in economic outcomes.

In evaluating the economics of ownership and leasing in the Sacramento market, like the balance of the state, it is generally more cost effective to dispose of buildings and lease space, compared to continued ownership – under current market conditions. Two examples would be illustrative:

1. **Office Building 8:** A renovation would be economically preferable to disposition and shift to leased space if there was a 50 percent reduction in space for each tenant, and the bond could be financed at a 3.5 percent interest rate.

2. **450 N Street Building:** this building is present vacant. If DGS relocated tenants from the most expensive commercial leases in the area to fill the building, it would still be cost-ineffective to renovate and own.

Despite this economic evaluation however, the volume of square footage owned by the State in downtown Sacramento, compared with vacant commercial office space, makes continued ownership in the state's best interest. RESD notes that a divestment of the state's office space portfolio in Sacramento would require significant new construction (raising rental rates higher than this analysis assumed), and the state's owned portfolio may be a meaningful contributor to rent stability in the region. In other markets, the state does not have a significant real estate holding such that divestment would materially impact those markets. In Sacramento, where the opposite situation is the case, a wholesale divestment would likely result in significant escalation of market rents.

Importantly, if state agencies were to return to the office full-time, divestment would largely be off the table (with very limited exceptions).

The question becomes, how much space might be needed? Unfortunately, that question is impossible to answer at present, and will depend on the numerous operational decisions made by state agencies in the next few years. Because of this, for these Sacramento buildings, RESD's recommendations are more nuanced. RESD does recommend the divestment of a number of Sacramento buildings (some of which are already underway) and holding in shutdown other buildings for the immediate future. This allows for time for departments to establish a new normal for their space needs, and for RESD to then refine its recommendations on which buildings to shed and which to renovate.

RESD recommendations are as follows:

1. **Clifford L. Allenby Building (Sacramento) – Retain and Maintain**

   This is a newly constructed building. Given its age and excellent condition, it would be amongst the last buildings to potentially be disposed of.

2. **New Natural Resources Headquarters Building (Sacramento) – Retain and Maintain**

   This is a newly constructed building. Given its age and excellent condition, it would be amongst the last buildings to potentially be disposed of.

3. **10th/O Office Building – "Swing Space" (Sacramento) – Retain and Maintain**

   This is a newly constructed building, and it would be amongst the last buildings to potentially be disposed of. Additionally, the building is intended to house Legislative and Executive Branch functions after the completion of the New Capitol Annex, with half of the building allocation going to the Legislature.

4. **May Lee State Office Complex (Sacramento) – Retain and Maintain**

   This is a newly constructed building. Given its age and excellent condition, it would be amongst the last buildings to potentially be disposed of.

5. **Gregory Bateson Building (Sacramento) – Retain and Maintain**

   This is a newly renovated building. Given its age and excellent condition, it would be amongst the last buildings to potentially be disposed of.

6. **Jesse Unruh Building (Sacramento) – Retain and Maintain**

   This is a newly renovated building. Given its age and excellent condition, it would be amongst the last buildings to potentially be disposed of.

7. **Resources Building (Sacramento) – Retain and Maintain**

   This is a newly renovated building. Given its age and excellent condition, it would be amongst the last buildings to potentially be disposed of.

8. **Stanley Mosk Library and Courts Building (Sacramento) – Retain and Maintain**

   This building completed a significant (but not complete) renovation in 2013. Given its age and condition, it would be amongst the last buildings to potentially be disposed of.

9. **Cal EPA Headquarters Building (Sacramento) – Retain and Maintain**

   This building was completed in 2000 and acquired by DGS at the end of a capitalized lease term in FY 23/24. This building will need end of life-related replacement of some building systems over the next decade but was generally well maintained during the prior 25 years. As such, RESD recommends retaining and maintaining the building.

10. **Rehabilitation Building (Sacramento) – Retain and Maintain**

    While originally constructed in 1950, the building underwent an extensive renovation that was completed in 2007. This building will need end of life-related replacement of some building systems over the next 10-15 years, but it is not in a condition that another renovation is immediately needed. As such, RESD recommends retaining and maintaining the building.

11. **East End Complex, Capitol Avenue, Blocks 171-174 (Sacramento) and East End Building, N Street, Block 225 (Sacramento) – Retain and Maintain**

    This complex was constructed in 2002-2003. This building will need end of life-related replacement of some building systems over the next decade but was generally well maintained during the prior 25 years. As such, RESD recommends retaining and maintaining the building.

12. **Agriculture Building (Sacramento) – Retain and Maintain**

    This building was constructed in 1936, is considered historic, and is directly adjacent to the State Capitol Building. The building underwent a renovation in 2005. The Agriculture Building will need end of life-related replacement of some building systems over the next decade, but it is not in a condition that another renovation is immediately needed. As such, RESD recommends retaining and maintaining the building.

13. **Paul Bonderson Building (Sacramento) – Retain and Maintain**

    Constructed in 1983, the Bonderson Building was identified as one the buildings in DGS' portfolio most in need of renovation. However, in FY 21-22, DGS was authorized to address the major issues identified in the 2015 Facilities Condition Assessments, as well as several additional cosmetic and infrastructure upgrades. This constituted a partial renovation and increased the life expectancy of the building. As such RESD, recommends retaining and maintaining the building.

14. **EDD Subterranean Building (Sacramento) – Retain and Maintain**

    This building is a small, single-story building located near Capitol Mall. It is partially below grade (hence the name), with a 120-child day care facility and public park sitting atop the structure. The building is currently being used as construction offices and could be utilized afterwards by state agencies as traditional office space. If not, the building could be repurposed as hoteling/conferencing space, or failing that, RESD would recommend the Facilities Management Division (FMD) utilize the space for operational needs in the downtown area. As such, RESD recommends retaining and maintaining the building.

15. **Blue Anchor Building (Sacramento) – Retain and Renovate**

    This small building was constructed in 1932, is considered historic, and is directly adjacent to the State Capitol Building. While a renovation does not pencil on its face, because of its small size, a renovation could be cost effective if tenants relocate from the more expensive leased space downtown and interest rates become more favorable. Because of the reasonably small cost of a renovation ($17-$20 million) compared to other buildings, and its location and historicity, RESD recommends renovation.

    One potential use of the building would be the relocation of the Government Operations (GovOps) Agency, the Business Consumer Services and Housing Agency, and/or the California Transportation Agency. While GovOps is in state-owned space, the leases for the other agencies bring a renovation close to being cost effective.

16. **Attorney General Building (Sacramento) – Retain and Renovate**

    This building, built in 1995, has as its sole tenant the Department of Justice. Justice also is the sole tenant at the Department of Justice Building in Sacramento. RESD recommends retaining and renovating the building as its systems approach the end of their useful life. Depending upon the level, if any, of space savings due to telework that may be able to be realized in the future, as the Attorney General Building is the larger of the two buildings, RESD recommends considering consolidating Justice into this building.

17. **Franchise Tax Board Campus (Sacramento) – Retain and Monitor**

    The Franchise Tax Board (FTB) Campus consists of seven buildings, totaling nearly 2,000,000 square feet. It is the largest campus in DGS' portfolio, and subject to lease revenue bonds until 2030. As such, divestment is not an option until after the bonds mature. At this scale, a bond-finance renovation would be considerably expensive, which is compounded by the fact that this building is off of the Highway 50 corridor. As leases in the general area are less than downtown, this makes the cost effectiveness of a renovation worse than other buildings. It is possible, however, given the security, parking, and overall space needs by FTB, relocation of that agency to alternative space will be difficult (if possible at all). For now, RESD recommends holding this building pending further assessment.

18. **Department of Justice Building (Sacramento) – Retain and Monitor**

    RESD recommends holding this building until a consolidation of Justice can be further evaluated. If a consolidation is feasible, RESD would recommend **divesting** of this building.

19. **Building and Grounds Headquarters (Sacramento) – Retain and Monitor**

    This small building is occupied by the Government Operations Agency and the Department of Transportation. RESD recommends working with Transportation to see if staff could relocate to the Transportation Headquarters building located nearby. In which case, DGS would seek to relocate GovOps and **divesting** of the building. If a Transportation consolidation is not possible, RESD would recommend relocation of both tenants to alternative spaces and divesting of the building. For now however, RESD recommends retaining and monitoring.

20. **Office Building 8 (Sacramento) – Retain and Monitor**

    This building was screened for housing suitability as an adaptive reuse project and scored well. However, unless hybrid is normalized, the amount of space it offers would likely be needed by the state. Given the age and condition of the building, RESD recommends retaining and monitoring until the next update to the Plan.

21. **Office Building 9 (Sacramento) – Retain and Monitor**

    This building was screened for housing suitability as an adaptive reuse project and scored well. However, unless hybrid is normalized, the amount of space it offers would likely be needed by the state. Given the age and condition of the building, RESD recommends retaining and monitoring until the next update to the Plan.

22. **March Fong Eu Secretary of State Building (Sacramento) – Retain and Monitor**

    Another significant, prominent building with a sole tenant (the Secretary of State), this building will need to be renovated in the next 10-15 years, and RESD recommends retaining and monitoring the building for now.

23. **Library and Courts Annex (Sacramento) – Retain and Monitor**

    The Library and Courts Annex (sometimes called the Library and Courts II Building, or the State Library Building) is the headquarters of the California State Library (the sole tenant). The building will need to be renovated in the next 10-15 years, and RESD recommends retaining and monitoring the building for now.

24. **Warren-Alquist State Energy Building (Sacramento) – Retain and Monitor**

    This building will be vacant in 2025 as tenants will relocate to the Gregory Bateson Building post-renovation. RESD recommends keeping the building in warm shutdown and retaining and monitoring the building for now.

25. **EDD Headquarters Building (Sacramento) – Divest**

    This building is in the process of being vacated as the tenants will be redirected to the Resources Building upon completion of that renovation in FY 2025/26. RESD projects this building to be excess to its overall space needs (even if there was a full return to the office), and the buildings underutilize the developable space. As such, RESD reaffirms its prior recommendation to divest of the building

26. **EDD Solar Building (Sacramento) – Divest**

    This building is attached to the EDD Headquarters Buildings and the same recommendations apply.

27. **State Personnel Building (Sacramento) – Divest**

    This small building was determined to be among the top 5 worse buildings in DGS' portfolio. It has historically been used as swing space for various downtown projects, and RESD reaffirms its prior recommendation to divest of the building.

28. **450 N Street Building (Sacramento) – Divest**

    In 2016, this building was recommended to be renovated and to serve as a consolidated home for departments within the Government Operations Agency. However, post-pandemic, with the significantly increased cost of construction, the renovation failed to pencil out and was scrapped. The tenants have already relocated to the May Lee Office Complex. RESD reaffirms its prior recommendation to divest of the building

Balance of the State

Outside of Sacramento, many of DGS' buildings are not near other DGS office buildings, and as such, stand alone. In a few instances, DGS does have a small cluster of buildings in a smaller geographic area (ex: two buildings in San Francisco and two in Los Angeles), but this is not the norm. As such, for buildings outside of Sacramento, each building evaluated independently of each other (with exceptions noted below).

1. **Northern/Central Region**

   a. **Red Bluff State Building (Red Bluff) – Divest**

   RESD projects a $28-$38M loss to the state for continued ownership. As such, the recommendation is to move tenants into leased space.

   However, there is no real commercial market to speak of in the area. This limits options to the following:

   - Option #1 – Renovate the building anyway. Though this is likely infeasible as it would still require leasable space for the existing staff to swing into.

   - Option #2 – Hold the building until market conditions change such that relocation is possible.

   - Option #3 – Work with Water Resources (the sole tenant) to find other accommodations, such as relocating the staff to other markets or moving entirely to remote work.

   RESD recommends Option 3, and failing that, Option 2.

   b. **Hugh Burns State Building (Fresno) – Divest**

   RESD projects a $270-$275M loss to state for continued ownership. In 2024, RESD conducted a study indicating the building was viable for adaptive reuse.

   In evaluating the leasable market in the area, there is an overall lack of availability in the regional submarket (central business district). However, the regional market does likely have enough space to accommodate tenants, even if it would be across multiple buildings.

   As such, RESD recommends disposal of this building and pursue affordable housing as a redevelopment strategy.

2. **Bay Area Region**

As a general note, contrary to expectations, the amount of state-leased office space in San Francisco and Oakland is relatively small compared to other regions. Moreover, some of these entities would prove difficult to relocate into state-owned buildings, limiting the potential for consolidation.

To the extent a consolidation is to be considered, it would more likely come from a consolidation of state departments from one owned building into another, rather than from leased spaces.

a. **Justice Joseph A. Rattigan Building (Santa Rosa) – Divest**

RESD projects an $69-$81M loss to the state for continued ownership.

There are limits, however, to the number of commercial lease opportunities in the area. Not counting space in the building associated with DGS facilities operations, the total allocation of space for tenants (not accounting for telework efficiencies) is approximately 61,000 SF. That amount of space would be difficult to locate in the market, but likely not impossible.

As such, RESD recommends working with the tenants to a) right-size their footprint, b) explore other locations, and c) relocate to available lease spaces.

b. **Elihu M. Harris Building (Oakland) – Retain and Monitor**

If the state were to return to a full-time workweek in-office, it would be cost-effective to continue owning the building. Additionally, in the event of the long-term use of hybrid, RESD tentatively projects that the cost to own will exceed the cost to renovate in this market.

However, it should be noted that the state leases relatively little space in Oakland. As such, assuming a 30 percent reduction due to telework efficiencies, the renovation scenario assumes relocating **all** commercial state leases into the building. Critically, this means that to the extent that a complete consolidation into these buildings is not possible, the economics could favor leasing.

Moreover, if telework efficiencies are greater than 30 percent, not only would the renovation result in vacant (non-rent paying spaces), but the reduced lease costs would likely result in the cost of continued ownership **exceeding** relocation to commercial spaces.

Given these variables, RESD recommends holding the building and reevaluating disposition strategies in the near term.

c. **Governor Edmund G. “Pat” Brown Building (San Francisco) – Retain and Monitor**

The Ronald M. George (RMG) State Office Complex (San Francisco) – Retain and Renovate

For the purposes of this analysis, RESD found that the high cost of leasing in San Francisco makes it considerably more economical to renovate these buildings than to transition tenants into leased spaces.

However, these two state office buildings are located less than a quarter mile from each other in San Francisco. And while each building could be evaluated individually, the lack of state-leased commercial office space in San Francisco makes conducting independent analyses more complicated.

The state leases approximately 96,000 SF in the area. Assuming a 30 percent reduction in allocated space at RMG, the building would need to find between 170,000 and 200,000 SF of new tenants. DGS could relocate all state office leases in San Francisco to the RMG Complex, and still have an underutilized asset.

Further compounding the analysis is that while the RMG Complex is a multi-tenant building, it is a complicated tenant mix. The RMG Complex houses courtroom spaces, including the California Supreme Court, that would be difficult to relocate. The Pat Brown Building, conversely, is colloquially referred to as the “CPUC Building” as the California Public Utilities Commission (CPUC) is the sole state tenant.

Accordingly, RESD reviewed a number of scenarios for these two buildings, adjusting variables accordingly. The goal was to identify how best to handle these two assets without resulting in underutilized office buildings.

Ultimately, RESD found that:

- Assuming a 30 percent reduction in space due to telework, the CPUC could relocate to the RMG Complex post-renovation. With respect to economics, this would be **considerably** more cost effective than disposing of the building and relocating tenants to leased space.

- It would take approximately a 27 percent reduction in space for a consolidation to be possible without impacting existing tenants. Any lesser reduction in space would require some existing tenants at the Complex to be relocated into leased space (for CPUC to fit).

    - For example, at a 20 percent efficiency, approximately 53,000 SF of space would be needed to be vacated by existing tenants for the CPUC to consolidate over. However, even with those costs added, the renovation would still prove to be considerably more cost effective compared to disposal of the building.

Obviously, if the state were to return to a fully in-office workweek, both buildings would be needed, and both would be more cost-effective to renovate compared to shifting to leased spaces. However, the cost to renovate the Pat Brown Building (including debt financing) is estimated to cost approximately $880,000,000. As such, RESD recommends the following:

- “Retain and Renovate” the RMG Complex.
- Place the Pat Brown Building in the “Retain and Monitor” category.
- Work with the CPUC on potential relocation options, to determine if there are space options that could be considered that are beyond the scope of this analysis,
- Accordingly, reevaluate the need for the Pat Brown building and reclassify it as either “Retain and Renovate” or “Divest.”

3. **Southern Region**

a. **Mission Valley State Building (San Diego) – Divest**

RESD projects a $62M-$100M loss to state for continued ownership. At present, DGS has already divested of one building in San Diego (awarded for affordable housing), and RESD recommends disposal of this building as well.

b. **California Tower (Riverside) – Divest**

RESD projects a $140M-$176 loss to state for continued ownership.

In 2024, RESD conducted a study indicating the building was viable for adaptive reuse. Especially with the first floor already being a community-serving retail hub, RESD recommends disposal of this building and pursue affordable housing as a redevelopment strategy

c. **Junipero Serra Office Building (Los Angeles) and the Ronald Reagan State Building (Los Angeles) – Retain and Monitor**

These two state office buildings are located less than a quarter mile from each other in downtown Los Angeles.

For the Serra building, RESD projects a $40M-$42M loss to state for continued ownership under baseline assumptions. However, even minor adjustments to the Serra analysis would result in a swing towards ownership (such as a six-percent interest rate).

Reagan's economic analysis is similar, though the assumed space savings makes a material difference in the bottom line. At a 30 percent reduction, the economics for Reagan indicate divestment, with a projected $182M loss for continued ownership. Assuming a 5 day per week return to the office however, the economics of ownership improve considerably, and RESD notes that ownership could be justified. This is encouraging as Reagan houses a number of tenant agencies that would be difficult to relocate into a leased market (including the 2nd District Court of Appeals, which has a courtroom in the building).

However, these numbers are all highly depending on the assumed rental costs in the area. If the rental rates were to decrease, even by as little as $0.50 per foot, the economics swing back towards leasing.

Given these variables, RESD recommends holding both buildings and reevaluating disposition strategies in the near term.

Further, RESD recommends that a future analysis evaluate the possibility of consolidation. This would involve working with the tenants to determine if relocation to less expensive submarkets is possible. Given that Reagan is the larger building, and substantially newer, a relocation of some tenants to less expensive markets could allow a consolidation into Reagan and divestment of Serra.

d. **Van Nuys State Building (Van Nuys) – Divest**

RESD projects a $58M-$98M loss to state for continued ownership. If there was a significant leaning into space reductions (50%) and a reasonable interest rate (4.5 percent), a renovation would be more cost effective. However, this is unlikely to materialize.

As such, RESD recommends disposal of this building.