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State set to sell 11 taxpayer-financed office buildings to private investors

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California is poised to sell 11 state office buildings to a consortium of private investors for $2.3 billion who, in turn, will charge the state rent for at least 20 years to occupy the taxpayer-financed structures.

The unprecedented transfer of state property to private investors is set to close on December 15. However, that closing could be blocked by a lawsuit filed in San Francisco Superior Court challenging the deal. A hearing seeking a preliminary injunction is scheduled for December 10.

"In both the short and the long-term, the transaction will cost California taxpayers billions as the state becomes a tenant in the buildings it currently owns," the lawsuit alleges.

The Schwarzenegger administration, which advocated and inked the deal, has prepared an economic analysis that shows the sale saving taxpayers $2 million over 20 years by leasing rather than maintaining ownership of the buildings. After 20 years, however, the state's estimates show losses of several hundred million dollars from the transaction.

California's general fund is roughly $90 ***billion***. And the state's justification for the deal cautions that "economic analysis beyond 10 years in this industry is rare."

In the short term, the state stresses that the $1.2 billion California nets after retiring the bonds sold to pay for construction of the buildings can be deposited in the cash-starved general fund which is estimated to have a shortfall of $25.4 billion in the fiscal year that begins July 1, 2011.

"When the Legislature authorized the sale and the governor signed the legislation, the purpose was to generate revenue," said Eric Lamoureux, a spokesman of the Department of General Services which approved the sale.

"We identified buildings that could return the highest amount and also looked at offering a lease term that would be attractive to buyers and generate the highest net revenue possible for the state."

Critics of the purchase, who include State Treasurer Bill Lockyer and Controller John Chiang, say the measure squanders long-term, taxpayer-paid assets to reduce a small percentage of the state's current budget woes.

“I oppose the sale of state buildings and incurring the equivalent of more expensive, long-term debt to fund operating expenses for the current-year state budget," Lockyer said in a statement explaining why he voted against paying off the bond debt that allowed the sale to go through. "The deal is poor fiscal policy and bad for taxpayers."

The Legislative Analyst agreed.

In a November 5 letter to lawmakers, three weeks after the Schwarzenegger administration announced it was selling the state buildings to a consortium of private investors called California First, LLC -- an entity created specifically to bid on the buildings -- the analyst criticized the Schwarzenegger economic analysis of the sale. Property renovation cost estimates used by Schwarzenegger were overstated by 33 percent, the analyst said. The cost of property and earthquake insurance was overstated by 25 percent, and the value of the 11 buildings was understated.

"The transaction would be a major fiscal loss even under the shortest possible timeframe (of 20 years)," the analyst wrote, saying that rather than saving $2 million as Schwarzenegger claims, the state would spend $646 million more over the first 20 years of the lease than maintaining ownership, increasing to a financial drain of $1.4 billion over 35 years.

Whoever's estimates are to be believed, the sale is definitely a reversal of the state's long-standing policy, begun under GOP Gov. George Deukmejian in the 1980s and amplified by GOP Gov. Pete Wilson in the 1990s, of constructing state buildings instead of spending taxpayer money on leased office space.

Prior to construction of the Ronald Reagan and Junipero Serra buildings in downtown Los Angeles, the state paid more than 75 landlords across Los Angeles County millions in rent, the lawsuit challenging the deal notes.

Besides the two buildings in Los Angeles, an additional five in Sacramento are being sold including the headquarters of the state Department of Justice and the Franchise Tax Board. The state office buildings in Oakland and Santa Rosa are also being sold as are several buildings in San Francisco including the headquarters of the Public Utilities Commission.

Under the terms of the deal, the new owners of the buildings -- the state is given no right to repurchase the structures after 20 years -- will raise rent 10 percent every five years through the first 20 years. The state will continue to pay gas and electricity bills. The analyst says the state will also pay propety tax, significantly decreasing any fiscal benefit to the transacation.

New coats of paint to the buildings' interiors must occur on or after the first five years of the lease -- and every five years thereafter. Carpets will be replaced by the new owners every 10 years. California First says that the 450 state employees who work as custodians, managers or engineers in the 11 buildings can keep their jobs if they wish.

One of the complaints by critics of the deal is the lack of detail on exactly who the new owners of these buildings will be since all of the principals are privately held companies. Leading California First is Hines Interests, a Houston-based international real estate firm, and ACRE LLC, a private real estate equity firm headquartered in Irvine and New York with an office in Mumbai. ACRE stands for Antarctica Capital Real Estate, a consoritum of investors created to bid on the state buildings. The entity is an offshoot of Antarctica Capital, an international private equity firm, whose principal is Chandra Patel. Also participating in ACRE is Rich Mayo, a long-term real estate broker and developer in the Los Angeles metropolitan area. The state lists another nine companies, most of them privately held, as "additional equity investors." A number of them have offices in Orange County near Patel's.

Lamoureux said the state did not give those entities a great deal of scrutiny, focusing mainly on determining whether they could contribute the cash to make the deal pencil out. He said he did not know if there were records as to what percentage of the deal each of the nine entities held.

Among the buildings being sold is a building at 350 McAllister in San Francisco's Civic Center which is the headquarters of the California Supreme Court. Built in 1922, the stately edifice is listed on the National Register of Historic Places.

One of the arguments in the lawsuit challenging the deal is that permission is needed by the Judicial Council, the body overseeing the administrative arm of the courts, to sell buildings like 350 McAllister and the Ronald Reagan building in Los Angeles, which houses the chambers of the Second District Court of Appeal.

The private law firm hired by Schwarzenegger to defend his administration says that it is unnecessary to get Judicial Council approval and, even if it were, the law authorizing the building sale used the phrase "notwithstanding any other provision of law," which trumps whatever authority the council may or may not have over sales of court buildings.

"In this time of immense fiscal crisis, petitioners' meritless litigation may mean the loss of over $1 billion in revenue to the state, yet petitioners have no particular injury or complaint other than that they do not like the deal," wrote Andrew Stroud of Mennemeier, Glassman & Stroud in an opposition brief to the lawsuit challenging the deal.

"Petitioners' petulance hardly constitutes irreparable injury compared to the potential loss of significant revenue by the state."

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