



Regular Meeting

Item Number 8 – Open Session

Subject: Headquarters Occupancy Plans and Tower Leasing Update

Presenter(s): Lisa Blatnick, CalSTRS/ Greg Levi and Alexis Garrett, Jones Lang LaSalle

Item Type: Information

Date & Time: November 5, 2021 – 30 minutes

Attachment(s): Attachment 1 - Office Sector – Demand Insight, RCLCO Fund Advisers (RFA)

PowerPoint(s): Waterfront Leasing Strategy and Office Market Outlook

PURPOSE

The purpose of the item is to provide an update to the board on how the pandemic has impacted CalSTRS plans to occupy the headquarters expansion, as well as our opportunity to lease vacated space at 100 Waterfront Place to third party tenants at the request by the board at the September 2021 Regular Meeting.

DISCUSSION

Headquarters Occupancy Plans

The timing of the onset of the pandemic, and CalSTRS decision to transition to a blended work force for the near future, aligned well with the timing of when decisions needed to be made around the furniture selection and purchase. This has allowed the Headquarters Expansion team to explore additional opportunities to increase the flexibility of the workspace and allow for any future health protocols such as the ability to social distance. In addition, except for investments, the demand for additional seating has progressed slower in the near term than our original projections. With those factors in mind, the team has determined that an agile approach to the workstation design would best fit CalSTRS needs. The team has selected a freestanding kit of parts that can be reconfigured over time depending on business need. With freestanding furniture, desks can increase, decrease, or rotate without the need for a tenant improvement project or major reconfiguration. The team has also determined that a 20 percent reduction in the initial desk purchase is possible, while providing an increase in collaboration space throughout the staff work area, aligning with the

expected activities to occur when staff are working physically in the office. Initially, we will be installing just over 1,000 desks with the ability to add 240 more over time.

The decision of who will be moving to the expansion has not changed. Benefits and Services, Financial Services, Administrative Services and Audit Services will move to the expansion facility. Benefits and Services will occupy most of office levels five through seven, with Administrative Services on office level four, and Financial Services and Audits Services located on office level three. Staff that report to the office three or more days per week will be assigned a permanent workstation, and staff that are in the office two days or fewer will have the ability to reserve unassigned seating using a new desk booking platform. Areas dedicated to unassigned seating will be established based on business needs and can be adjusted at any time. We expect that additional smaller teams within technology services and public affairs could be accommodated in the expansion, either allowing for additional space to be leased in our existing tower or providing additional room for growth for the investments branch.

Tower Leasing Strategy

The financial analysis that was developed for the for CalSTRS long-term facilities strategy included revenue based on leasing assumptions for the existing tower. The board requested information on how remote work will impact our ability to lease our available space now and in the future. Attached is an opinion letter from the board’s real estate consultant RCLCO Fund Advisers (RFA) on the impacts the pandemic has had on the national leasing market. In addition, below is the outlook of the leasing market in the Sacramento region from the perspective of Jones Lang LaSalle (JLL), the leasing agent working with CalSTRS on the marketing of the existing tower.

Initial Leasing Strategy (Pre-Covid)

- The leasing strategy kicked off in the Fall of 2019 with a projected delivery of six full floors at Waterfront Place in late 2022 to early 2023.
- The vacancy rate in the Sacramento market was approximately 12%, a healthy rate for our market. Much of the vacancy was found in older Class B office product, with approximately 25% vacant. Meanwhile, the vacancy rate in Class A office properties in Downtown Sacramento was tightening with only 7% vacant in Q3 2019, decreasing to 5% by Q1 of 2020. This was driven largely by a “flight to quality” office product.
- Large corporate users were active at the time, focused on well-located amenity rich campuses that would enhance a company’s ability to recruit and retain top talent. Top on the list of building search criteria was LEED sustainability, robust on-site amenities for employees, collaborative workspaces, and public-transit oriented projects.
- There had been no new significant office buildings built since 2009. The newest office product was 10 years old, while on average the office supply in Sacramento was 30 years old.
- There were no large blocks of Class A space available larger than 15,000 square feet, creating upwards pressure on lease rates.

- The State of CA was a very active tenant at that time even with the 3 million square feet of office product planned, the new State office projects were reportedly oversubscribed, pushing the State to continue to seek office space in privately held buildings.
- Developers were beginning to consider new speculative office developments in downtown Sacramento as the rental rates were reaching a point where such projects could be financially viable.

March 2020

- The onset of Covid beginning in March 2020 put an abrupt stop on all office market activity for the next 6-9 months.
- Speculative office projects were put on hold.
- Many companies adopted temporary work from home policies.
- The pandemic impacted where people chose to live.
- Major coastal cities saw population declines, while regions like Sacramento experienced population increases, according to recently released California Department of Finance 2021 population and housing estimates.
- Among the 30 largest U.S. Metropolitan areas, Sacramento saw the most net-move-ins in 2020, most of which came from San Francisco. Moves from San Francisco County to Sacramento County increased by 70% with Bay Area (including Oakland and Berkley metros) migration to Sacramento increasing nearly 38% in 2020. That increase accounted for a net gain of 12,750 new residents in Sacramento, a 0.5% growth of our metro area population, using U.S. Postal Data.
- People were able to relocate because of the increased flexibility allowed by expanded work from home policies and the rise in zoom/ teleconferencing and remote meetings.
- As a result, traditional office demand drivers were impacted, creating change to how workplaces are used while also strengthening other aspects of office space use.

Today's Market Conditions

- Companies are continuing to plan for reoccupation of their offices.
- Companies are evaluating what their future office will look like with many choosing to adopt a hybrid model, which could affect their total office square footage need.
- Rental rates have remained relatively unchanged despite the lack of leasing activity and new vacancy; however, concessions in the form of free rent and tenant improvement allowances have started to increase.
- The State of CA has continued to build its own buildings through the pandemic and has now delivered nearly 2 million square feet of office space for its own use, with another 1 million square feet under construction.
- We do anticipate more significant move-outs as the State of California vacates private office buildings to locate in the newly constructed State office buildings, which could affect our market conditions in the future.

- People that have moved to Sacramento are telecommuting with occasional visits to the office. This has created a “hub and spoke” model that we are seeing corporate users adapting to in Sacramento.
- There are still no speculative office developments under construction to impact supply for private office users.
- There continues to be a lack of quality space in Sacramento and market activity is starting to increase. Active users include construction fields such as architectural engineering, construction, life science and technology users.
- The “flight to quality” has only intensified as companies look to offer their employees healthy and safe workplaces that address today’s top concerns.

Today’s Leasing Strategy - Adjustments to Marketing Efforts

- The Waterfront Place leasing website designed for the property is user friendly and allows people to understand the project, even while they may not be comfortable or able to visit it. [Your Future Workplace: Waterfront Place Office Tower](#)
- Self-paced virtual tours have been created with 360-degree Matterport cameras for the vacant space and the amenity spaces in the building. This allows prospects to tour the building and navigate through spaces at their own pace if they cannot physically visit the project.
- JLL produced a professional story-telling video using drone technology to capture the extraordinary views at Waterfront Place, giving a feel for being on the campus, walking through the building, and exploring the features and amenities. [Experience Waterfront Place](#)
 - Marketing materials have been enhanced to focus on what today’s tenants want, with a focus on:
 - Health, wellness, and safety
 - Healthy buildings, air quality, and cleaning protocols
 - Easy access to parking
 - Healthy foods, on-site café using organic produce
 - Fitness facilities with access to outdoor walking areas
 - Access to on-site childcare
 - Outdoor spaces for tenants to congregate in open space, allowing social distancing
- Waterfront Place continues to be well positioned in the market. The available space is the largest block of contiguous office space in the Downtown area, making it an attractive option for a large office user. The building offers excellent ownership and management, quality and flexibility in design and advanced sustainability, while also providing a superior healthy workplace environment for its occupants – all factors that are top of mind for decision makers.

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Greg Levi and Alexis Garrett from JLL will be present at the board meeting to present additional details and answer any questions the board may have.

MEMORANDUM

DATE: October 1, 2021
TO: California State Teachers' Retirement System
FROM: RCLCO Fund Advisors – Taylor Mammen and Ben Maslan
SUBJECT: Office Sector – Demand Insights

National office fundamentals have deteriorated over the past year as the pandemic has taken its toll, with increasing vacancies, decreasing rents, and negative absorption. Net leasing activity has now been negative for four consecutive quarters, resulting in more available space and a contraction in rents.

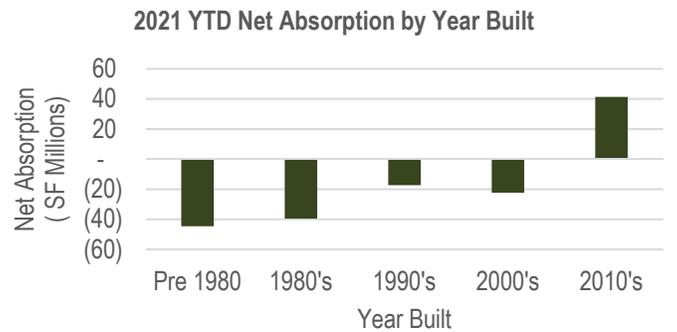
Indicators of future interest in office space, however, have rebounded, indicating that absorption will improve. In anticipation of an eventual reopening, the amount of space toured by prospective tenants with active requirements for new office space, an indicator of future leasing activity, increased steadily over the first half of 2021. The chart to the right, comprised of an index of touring activity,¹ illustrates this trend; touring activity plummeted during 2020 during the peak of the pandemic, but has since rebounded to near pre-pandemic levels.

We do, however, see a clear bifurcation between older, commodity-like office space and newer product, that began to emerge pre-pandemic and will likely continue. Tenants have shown a willingness to pay a premium to locate in the newest office product. Recently delivered office buildings are relatively scarce, representing only 9.8% of current supply, and have out-performed older assets, with demand for high quality office buildings continuing even during the pandemic. Indeed, the chart to the right shows that while most office buildings have lost tenants during 2021, newer office buildings (those built after 2010) have recorded 40M SF of positive leasing activity.

As the Delta variant spread recedes and mask mandates are lifted, we expect that tenant demand for office space will rebound, although with considerable uncertainty due to the changing landscape of office usage. We anticipate that, despite this uncertainty, the trend of newer office space outperforming to continue into the future, as tenants demand high quality office space.



Source: VTS



Source: Costar

¹ The VTS Office Demand Index reflects the total square feet toured in a given month by tenants with active requirements for new office space relative to total square feet. The index measures the sentiment of prospective office tenants based on their requirements.