

EXERCISING OPTIONS TO EXTEND THE TERM OF A LEASE [as a result of change to Standing Order 100.4 (cc)]

QUESTIONS AND ANSWERS:

1. *What is the change to Standing Order (“S/O”) 100.4 (cc)?*

Effective January 18, 2001, S/O 100.4 (cc) no longer includes option terms in the determination of the President’s authority to approve and execute leases¹ and other documents pertaining to the use of facilities for University-related purposes (“University as Tenant”). A lease with an initial term of up to 10 years and multiple options to extend a lease can now be signed by the President acting alone or by the President with the Concurrence of the Chairmen of the Board and the Committee on Finance (Concurrence Item). The President’s authority (acting alone) was delegated to the Senior Vice President (DA2133) who in turn redelegated portions of his authority to Assistant Vice President Michael J. Bocchicchio (“AVP”) (November 2003). The President has issued a revised delegation to the Chancellors, Laboratory Directors and Vice President-Agriculture and Natural Resources (collectively the “Campus(es)”) to include, among other areas, the new treatment of options (DA2140).

2. *Why was this change made?*

The reason the change was made is two-fold: (i) to reduce the number of otherwise routine lease transactions going to the Board of Regents for approval, and (ii) to remove disincentives that might otherwise prevent the Campuses from obtaining favorable options when appropriate. Prior to January 1, 2001, all leases with a total term (including options) longer than 10 years required full Board approval. Obtaining options during lease negotiations is to the benefit of the tenant and does not represent an obligation of the tenant until exercised. Therefore, the exercise of each option to extend the lease should be viewed as a NEW DECISION (whether to stay or consider other space alternatives). Thus, the authority pertaining to the decision to exercise an option is now comparable to a lease renewal (where an option right was not otherwise available) or a new lease transaction.

3. *How will this affect the exercise of options to extend included in leases signed by the President, Senior Vice President, Campuses or AVP?*

Effective January 18, 2001², all extension options contained in leases approved and executed by the President acting alone and by the President with the Concurrence of the Chairmen of the Board and the Committee on Finance are not approved as part of the lease transaction, but should be treated as a NEW lease transaction (or lease renewal) at the time the option to extend is exercised. Therefore, as with the initial lease term, the length of the option term, the value of the first year’s rent and the total projected rent over the option term will determine who is authorized to approve and execute any documents required to memorialize the exercise of the option. Consequently, when exercising the option, the individual having authority to approve a new lease for the same term should execute the lease amendment (preferred) or such other document approved by Office of General Counsel. Refer also to the Approval and Execution Authority for Amendments matrix.

4. *Will there be a change in the exercise of options under leases approved by the Board of Regents?*

No. As always, the Regents Item contains language that addresses how options to extend a lease are handled. Depending on the language of the Regents Item, the authority to execute a document to extend the term of a lease may have been delegated to the President.

¹ For purposes of this discussion, the questions and answers refer to leases with the University as Tenant. When the University is the Landlord, the term limit is 10 years (INCLUDING options).

² The date applicable to leases executed by the Senior Vice President is 7-26-2002, and 11-3-2003 to leases executed by the Campuses.

5. *Why shouldn't options to extend be excluded in Regents Items if options are to be treated as new transactions?*

With regard to Regents' actions, it seems appropriate to obtain approvals for option terms in order to stay with the overall intent of reducing the number of routine lease matters going before the Board of Regents (see Question #2 above). Lease transactions now going before the Board of Regents for approval are primarily the result of the initial annual rental payment exceeding Presidential approval authority rather than the term of the lease (unless the initial term of a lease is beyond 10 years). If options were not included in the initial approval of a Regents Item, at the time an option is exercised, the transaction might require Board of Regents' approval again because of the high annual rent.

6. *How will the change in the S/O affect an option included in a lease executed at the Campus level after 1-1-2001 and before the issuance of DA 2140 on 11-3-2003?*

The then-current delegation (DA 2116) limited the initial term of a lease to a term not to exceed 5 years and a total term, including options, not to exceed 10 years. Thus the change in the President's Standing Order does not affect the exercise of options for leases executed under the Campus' delegated authority during that time period. Those options have already been approved. Regardless, each Campus should view the exercise of any option just like a renewal or new lease transaction and exercise appropriate due diligence before exercising such options.

7. *What other considerations may play a role now that options to extend are excluded?*

The UC Guidelines on Capital Leases ("Guidelines") state that options to extend a lease may be considered part of the lease term if the rental for those options is potentially less than market rent or if the University paid for substantial tenant improvements not considered fully amortized over the initial term. Specifically, if it can be projected at the commencement of the initial term that the rent or other terms of the option are so much lower than fair market rent or otherwise so favorable that exercise of the option is reasonably assured, then the option term must be included in the lease term for the purposes of the 90% test described in the Capital Lease Criteria of the Guidelines. Please consult with OP's Real Estate Services Group regarding questions on this issue.

8. *If options are considered new transactions, do Campuses have to request a new seismic evaluation?*

No - unless there has been an update to the UC Seismic Safety Policy for Purchased and Leased Buildings since the property was last evaluated and that invalidates the existing documentation regarding the building's compliance with the policy.

9. *What about other due diligence items undertaken by Campuses for a new lease transaction?*

As each extension option is comparable to a new lease transaction, the then applicable due diligence procedures for such a transaction should be followed. For leases containing options with a predetermined rent structure, which may exceed the then market rates, it is imperative that the Campus conducts a market study to assess whether to forego the exercise of the option and renegotiate a lease renewal at market rates or to relocate.

10. *According to RESG's matrix Authority to Approve and Execute Real Estate Transactions for University-related Purposes, options granted by the University to tenants (UC as landlord) are not excluded under the President's approval and execution authority. Why?*

S/O 100.4 (cc) limits the President's authority to enter into leases to a term not to exceed 10 years (excluding options). It means that the maximum term the President is able to commit the University to is 10 years. If the University, as landlord, grants options to tenants, it is the tenants' election whether or not to exercise the option. The President does not have authority to give a third party the right to extend the University's commitment to more than 10 years.