

MEMORANDUM

To: Health Connector Board of Directors
Cc: Louis Gutierrez, Executive Director
From: Andrew Egan, General Counsel
Date: December 10, 2020
Re: Renewal of Lease at 100 City Hall Plaza

BACKGROUND AND SUMMARY

The Health Connector is seeking Board approval of a renewal of the lease on the premises at 100 City Hall Plaza. Currently, the Health Connector leases 19,120 square feet of space on three separate floors (3rd, 5th and 6th) in 100 City Hall Plaza, from the landlord, Sears Crescent Building LLC. The Health Connector has been in the building since early 2007, shortly after it was established. The building was sold to the current landlord on April 15, 2016.

Currently, there are three separate leases, one for each floor and each expiring on August 30, 2021. Each of these leases was renewed in 2015. The current cost is \$42.13/square foot (reflecting a base rate of \$39/square foot plus \$3.13/square foot in “escalations,” which represent increases in certain operating expenses for the landlord, such as real estate taxes and the costs of operating common areas, which accrue over the course of the lease), and thus our current rental payment is \$745,680 per year, plus operating expenses.

Beginning in January 2020, the Health Connector undertook an extensive market review to determine whether it would be favorable to move to a different comparable location, or whether renewing with the current landlord would instead be preferable. That process included tours of similarly classed properties, reviews of formal proposals from those properties, and reviews of fit plans to determine feasibility of moving Health Connector staff to such other locations.

The current landlord provided a renewal proposal in September, and the Health Connector engaged in discussions with the landlord to produce a final proposal, reflected below. These reviews gave the Health Connector important information with which to evaluate the current landlord’s proposed renewal when it was provided in September. Further discussions with the current landlord produced a proposal that includes modest increases in rent, the ability to make improvements on the space, and flexibility to respond to potential changes in office space needs that may result from new models of work in a post-COVID-19 world. The renewal proposal compares favorably to moving to a new location.

PROPOSED LEASE RENEWAL TERMS

After discussions with the landlord, we have come to an agreement, subject to Board approval, on the following terms:

Rent and Improvement Allowance/Rent Abatement

- The Health Connector's rent for October, November, and December of 2020 (viz. on the current lease) will be abated, equaling a savings of \$186,420.
- Commencing September 1, 2021, the leases for all three floors will be renewed at their current rate, with new rates beginning on December 1, 2021. The term of the renewed lease will be 63 months, ending on November 30, 2026.
- The Health Connector's rent for September, October, and November of 2021 (viz. on the first three months of the renewal term) will be abated, equaling a savings of \$186,420.
- For the 6th and 5th floors, the Health Connector will be provided with an improvement allowance totaling \$344,500. This amount may be used to abate the Health Connector's rent, if no improvements are desired. The Health Connector does not have any currently expected improvements to make.
- Assuming that the Health Connector chooses to use the full improvement allowance to abate the rent, and accounting for the abatement of October, November, and December 2020, averaged over the 63-month term of the lease, the effective price per square foot will be \$45.26¹, or \$865,461 per year. The amount of improvement allowance that may be used to abate rent is apportioned over the term of the lease, starting on the second anniversary, in accordance with the following schedule:
 - Beginning September 1, 2022: Abate \$44,500
 - Beginning September 1, 2023: Abate \$100,000
 - Beginning September 1, 2024: Abate \$100,000
 - Beginning September 1, 2025: Abate \$100,000
- Again assuming that the Health Connector chooses to use the full improvement allowance to abate the rent, the total annual cost, starting December 1, 2021, is as follows:
 - Year 1: \$976,678, plus operating expenses
 - Year 2: \$951,298, plus operating expenses
 - Year 3: \$914,918, plus operating expenses
 - Year 4: \$934,038, plus operating expenses
 - Year 5: \$953,158, plus operating expenses

Right to Terminate

The Health Connector has obtained an optional right to terminate the 3rd floor early, after the third full year of the lease (i.e. no sooner than December 1, 2024), if it determines that it does not need as much office space. At 5,340 square feet, the 3rd floor represents 28% of the total leased space. This requires 9 months' notice. The total cost savings the Health Connector would realize by terminating early is equal to the final two years' of rent for the 3rd floor, or \$571,380.

¹ Note: As is standard in commercial leases, and as is true for the current lease, the landlord will add in "escalations" each year after the first year, based on the actual increases in the landlord's costs in real estate taxes and operations of common areas. The \$45.26 figure does not reflect those anticipated costs, which are not knowable in advance. However, for purposes of comparison, we can assume that any escalations we might incur are equivalent to what we might otherwise incur elsewhere.

Right to Sub-lease

As has been the case throughout its tenancy, the Health Connector may sub-lease some or all of its space at any time, with prior approval of the landlord, such approval to not be unreasonably withheld. (Note: Another tenant is currently sub-leasing its space on the 5th floor.) This may also be a means of reducing excess office space, should that need arise.

Other Conditions

The remaining conditions will remain unchanged from their present state. The terms are standard commercial lease terms.

ANALYSIS

Health Connector staff believe this lease renewal is advantageous financially. The proposed rates are competitive with comparable space. As described above, prior to commencing negotiations, the Health Connector reviewed comparable space at four office buildings in the downtown area. These were the few buildings available in our target area. Starting rents for these alternate spaces were around \$65/square foot, and would have increased annually. One outlier space had a starting rent of around \$44/square foot, but this price was highly unusual and specific to that property, and ultimately the space was not made available to the Health Connector. Even once COVID-19 became a reality, the prices of the spaces the Health Connector had reviewed remained steady and did not change, reflecting a general resilience in the prices of the commercial real estate market. Thus, of the available spaces the Health Connector reviewed, an effective rate over the term of the lease of \$45.26 compares very favorably. Further, it is a benefit to be a tenant with a long-term landlord, not interested in incurring any vacancy.

As discussed above, the Health Connector, like other private and public employers, will be reviewing the future of its office space needs, based on the lessons learned from working remotely in response to COVID-19. We do not yet have enough information to make a determination about the right configuration of remote and in-office work expectations, but should we determine that, post-COVID-19, we do not require every employee to report to the office every day, we may find that we have leased more office space than necessary. The right to terminate the 3rd floor and the right to sub-lease represent important flexibilities that allow the Health Connector to make an appropriate determination about its office space needs, ultimately potentially saving money by reducing its office footprint. In the meantime, as described above, the lease renewal contains favorable terms in a Boston real estate market that has only become more competitive, and represents significant savings when compared to moving, including because other rents were so much higher and because it avoids the cost and disruption involved in moving.

CONCLUSION

Consistent with the foregoing, Health Connector staff recommends renewing the lease on the 100 City Hall Plaza premises along the terms outlined herein.