



## Teacher Retirement System of Texas **Investment Management Division**

### Indeed Tower Update

Brian Guthrie, Executive Director

Andrew Roth, COAO

Jase Auby, Chief Investment Officer

Eric Lang, Senior Managing Director

Jerry Albright, Senior Managing Director

February 2020



# TRS Long Term Facilities

## Indeed Tower Communications



### Media Stories

21

#### INCLUDING:

Austin American-Statesman  
Institutional Investor  
Education News  
Longview News-Journal  
Austin Business Journal  
KXAN  
Texas Scorecard  
KETK Fox 51



### Facebook Comments

3,506

#### INCLUDING:

**754** public comments on TRS Facebook  
**1,902** public comments on TRTA Facebook  
**827** public comments on Statesman Facebook page  
**23** private messages



### TRS Comments

60

#### INCLUDING:

*"It is shameful that our money is spent for the luxury of those who are entrusted with our future while retired teachers must go without what they deserve. Needless to say, we are all furious. Do something about it."*



### Compact with Texans Comments

97

#### INCLUDING:

*"When our insurance premiums are so devastatingly expensive for coverage that leaves us in a position where we can't afford to actually get sick, and even worse coverage facing us at retirement, you're asking us to accept that is the best deal you can find for office space?"*



### Letters and Phone Calls

27

#### INCLUDING:

**9** Member letters  
**18** Member phone calls



### Legislative Communication

12

TRS has received correspondence from twelve legislators, and others have tweeted about the Indeed Tower lease. The Senate Finance Committee will hold a hearing on February 25, 2020, and the House Committee on Pensions, Investments, and Financial Services will also hold a hearing March 9, 2020 to discuss TRS' long-term space planning.

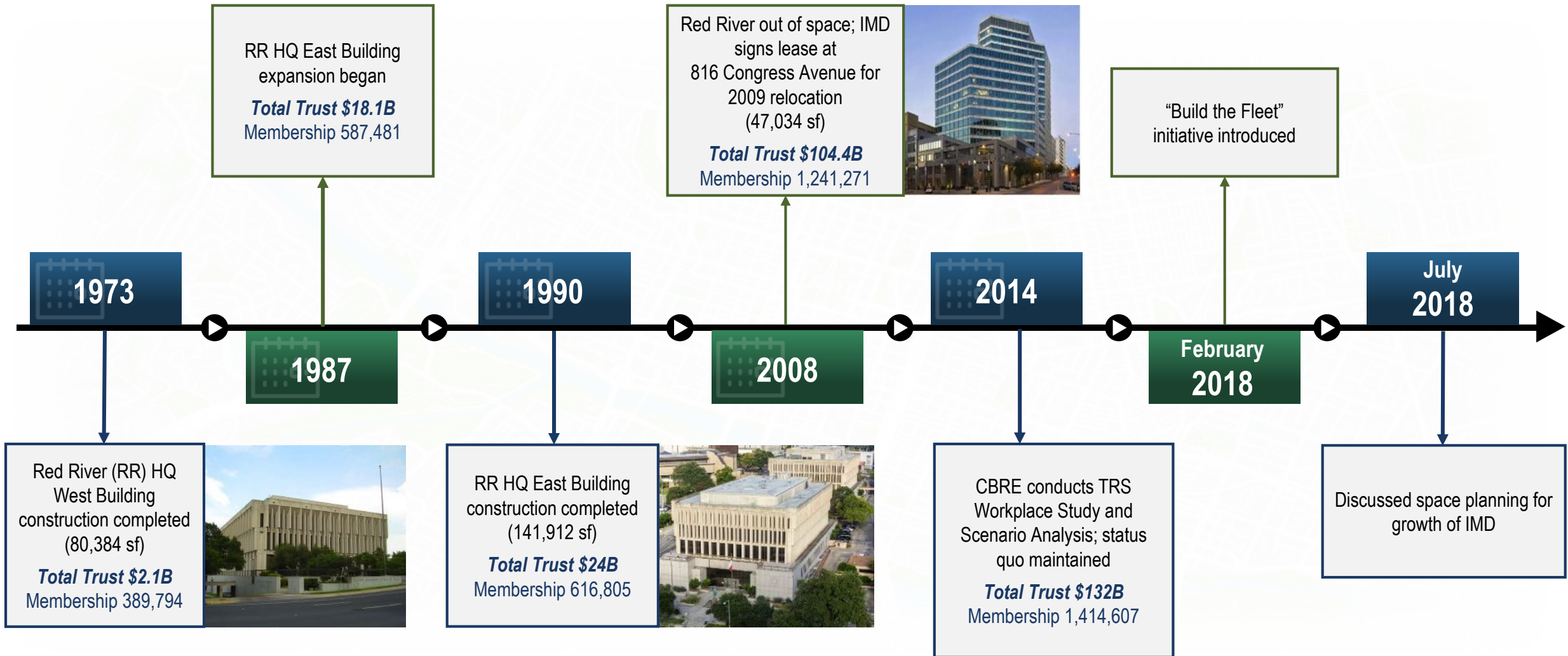
# TRS Long Term Facilities

## *Agenda*

- TRS Long Term Facilities Timeline
- History of IMD Facilities
- Independent Fiduciary Review of Process
- History of Proposed New Headquarters (“New HQ”) Building
- IMD Lease Options
- Downtown Austin Market Update
- Recommendation

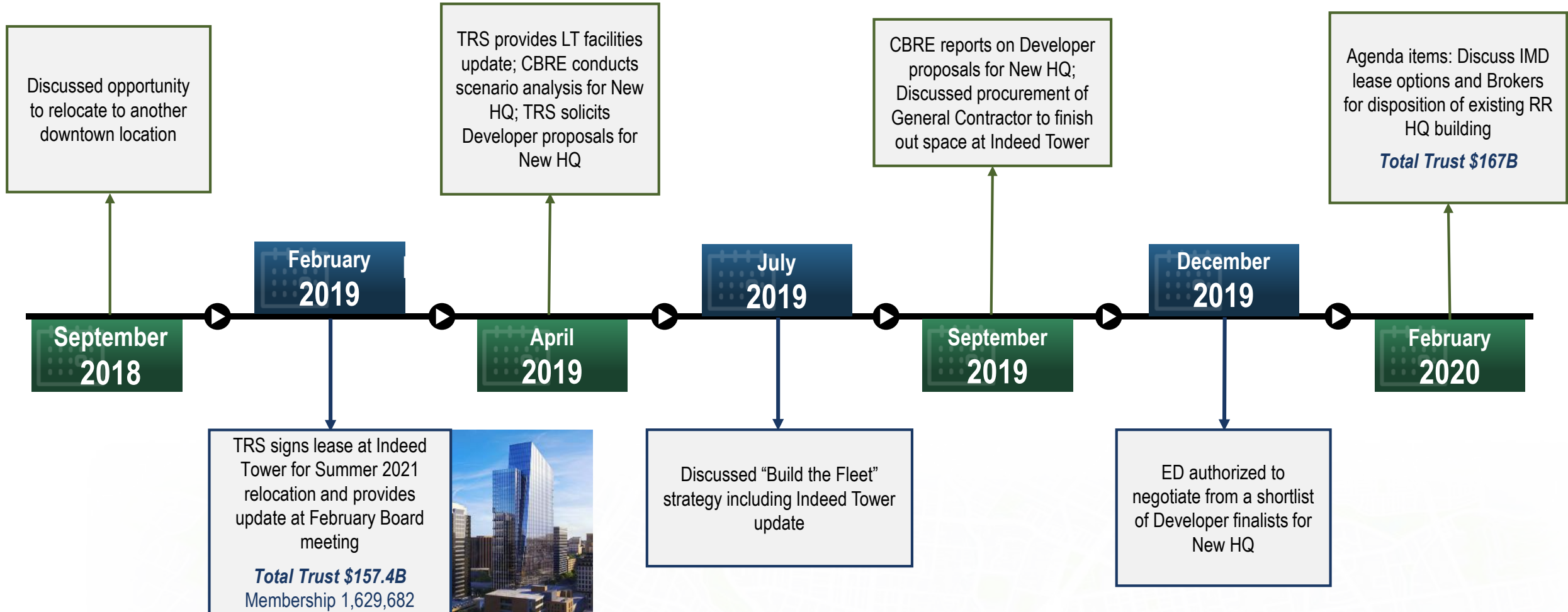
# TRS Long Term Facilities

## 1973-2018: Timeline



# TRS Long Term Facilities

## 2018-2020: Timeline



# TRS Long Term Facilities

## 2008: IMD Relocates to 816 Congress Avenue

### History and Options Considered

- Investment strategy shift in 2008
  - Significant increase in diversification and use of external management
  - IMD to expand from 80 to 140 headcount
  - Minimum of 45,000 sf required
- Space options considered
  - Lease new office space
  - Build new facility
  - Purchase a building
  - Invest in an existing building and lease remaining space
- TRS evaluated several locations with 6 finalists:
  - 3 downtown Austin
  - 3 in non-downtown Austin
    - Domain, North Austin, Far Northwest Austin

### Conclusion

- Decision was made to stay in downtown location
  - Space available immediately
  - Enabled TRS to build out efficient infrastructure
  - Cost competitive
  - Central to:
    - Red River headquarters
    - Employees and major transportation arteries
    - State investment funds
    - Investment partner visitors
  - Offered ability to easily expand if necessary
- Board authorizes leasing of office space for IMD
  - Lease executed at 816 Congress for 47,034 SF in 2008
  - Moved in March 2009

# TRS Long Term Facilities

## 2014: CBRE conducts TRS Workplace Study

- CBRE performs workplace strategy, provides occupancy scenarios and market options
  - Launched February 2014, update provided in June 2014 with final results presented July 2014
  - Scope included current space analysis, surveys, visioning sessions, real estate market survey and financial modeling
  - Consensus view to maintain status quo where IMD and RR would remain at current locations

Options Considered	Description	Conclusions
Status Quo	IMD and RR remain at current locations	<ul style="list-style-type: none"><li>• Departments have similar aspirations about space but functionally have different needs</li><li>• Downtown consolidation is best option operationally for the IMD</li><li>• Consolidation in suburbs is the best option from a cost standpoint</li><li>• Ownership is advantageous given time horizon of occupancy but constrained by current market strength</li></ul>
IMD at 816 Congress and Exit Red River	IMD remains at 816 and RR moves to new location	
Separate Member Service Center	RR and IMD co-locate to new facility downtown and Benefits moves to suburban location	
Co-locate	All TRS together in one location	

# TRS Long Term Facilities

## *2018: Build The Fleet initiative introduced*

- TRS reaches goal of modernizing the investment management division, diversifying the portfolio, and increasing alpha to become top US pension
  - Over next 10 years, IMD seeks to maintain its success and become a top global investment fund
- Priorities:
  - Achieve actuarial rate of return
  - Scale investment programs with Trust asset growth projections
  - Increase internal management capabilities for cost effective investments
  - Improve retention of investment personnel
- TRS projects estimated savings of \$1.4 billion in fees and carried interest from our investment activities over next 5+years
  - Will require hiring another 120 FTE taking headcount from 150 to 270
    - 270 does not include contractors, secondees and shared services support
  - Total estimated IMD headcount (including contractors, secondees and shared services) is estimated at 350 by 2031
- Initiative will require additional space
  - In August 2018, IMD expanded by 18,660 SF at 816 Congress to accommodate the first phase of “Build the Fleet,” for total of 73,659 sf
  - Approximately 75% of the lease at 816 Congress expires in March 2021, while remainder expires December 2022

# TRS Long Term Facilities

*2018-2019: IMD negotiates relocation to Indeed Tower*

## ***Background:***

- Since inception in 1937, TRS has been in downtown Austin
  - TRS determined it was prudent to stay downtown in 2008, 2014 and 2018
- IMD expanding as a result of “Build the Fleet” initiative
  - 75% of the lease at 816 Congress set to expire in March 2021
- Limited availability of large contiguous Class A office space in downtown
  - 816 Congress was fully leased
  - Expert market reports also indicated limited availability
- Market base rental rates as of 2018 at 816 Congress ranged from \$33.00-\$34.00 PSF
  - At March 2021 lease expiration, monthly contractual base rent is \$177,100 (\$28.85 PSF) for 73,659 SF
  - Assumed increase on renewal to a new market rent of \$35.00 PSF in 2021
- Opportunity to pre-lease at Indeed Tower
- Ability to obtain lower rent in early construction phase of building

# TRS Long Term Facilities

## *2018-2019: IMD negotiates relocation to Indeed Tower*

### ***Rationale:***

- A downtown location is consistent with other public funds and also to private investment managers
  - Several state investment funds with assets in excess of \$400 billion are managed centrally in Austin
  - TRS trades in 56 countries which requires a 24-hour trading group and on-site investment operations group
  - Downtown location allows for more efficiency to schedule meetings with financial partners
    - TRS has 191 external manager relationships
    - Over 1,300 meetings annually with external partners with approximately 2,200 visitors
- As a global institutional investor, a location in close proximity to downtown is essential for attracting and retaining a quality investment team
  - TRS investment portfolio generated \$7.1 billion in excess of the Trust benchmark over the past 10 years
  - Austin considered an “Innovation Hub”
    - 150 company relocations to Austin in last 3 years
    - Austin consistently top ranked as one of the best places to live

### ***Conclusion:***

- TRS signs 10-year lease commencing June 2021 for 101,673 SF
  - Annual base rent of \$38.50 PSF with \$0.75 PSF annual increases
  - Monthly base rent at Indeed begins at \$326,201
    - \$296,546 for same square footage at 816 Congress (based on \$35 PSF base rent)
  - Indeed Tower is expected to have initial lower operating expenses than 816 Congress
    - Indeed Tower’s rectangular floor plate allows for more efficient space utilization than 816 Congress

# TRS Long Term Facilities

*2018-2019: IMD negotiates relocation to Indeed Tower*

## ***Summary:***

- IMD was outgrowing space and planned for future growth
- IMD needed to add headcount to save \$1.4 billion in fees and carried interest
- Sufficient space was not available in the downtown market
- Indeed Tower rent was comparable to current location

# TRS Long Term Facilities

## *HQ Options*

- Staff will continue diligence on long-term facilities options
- The ultimate decision depends on four essential components:
  - Cost of a new headquarters building outside of the downtown business core
  - Value of the existing Red River campus
  - Cost/benefit analysis of renovating and expanding Red River campus
  - Evaluation of member and business needs
- At this meeting, the Board will consider the selection of a broker to explore value of RR campus
- Exclusive negotiations with developer finalists for a potential New HQ are underway
  - Leading candidate is in the Mueller development
  - Potential cost for a new headquarters building at Mueller is estimated to be at least \$150-\$200 million
  - Cost will be offset by proceeds of disposition of RR campus and compared against the cost of renovations
- Consideration of Regional Offices to better serve member needs
  - One pilot office under review

# TRS Long Term Facilities

## *2019-2020: Red River HQ Broker Solicitation*

- Solicitation for brokerage services for the disposition of the Red River property:
  - Three finalists interviewed
- Scope of Work
  - Evaluate highest and best use of the TRS Red River Headquarters property, including fee simple sale, ground lease, or contribution to joint venture disposition



# TRS Long Term Facilities

## *Indeed Tower Update*

- Since initial lease negotiations with Indeed, the options for 816 Congress have changed
  - Space has become available at 816 Congress
  - The 816 Congress landlord can provide IMD the ability to expand in the building
    - Space would not be contiguous to IMD's existing space
  - IMD expansion at 816 Congress may be phased in over time
- A proposal from landlord shows base rent at 816 Congress is similar to the previously projected rent
  - Since IMD is the largest tenant in the building, the landlord is being competitive in attempt to retain the IMD's tenancy in the building
- Tenant improvement costs at 816 Congress are significantly lower than building out new space at Indeed Tower

# TRS Long Term Facilities

## IMD Lease Options

	Option 1 816 Congress Extend for 7 years	Option 2 Move to Indeed Tower	Option 3 816 Congress Extend for 5 years	Option 4 816 Congress Extend for 10 years
Size	95, 269 SF	101,673 SF	95, 269 SF	95, 269 SF
Base Rent PSF	\$34.00 PSF	\$38.50 PSF	\$34.00 PSF	\$34.00 PSF
Strengths	<ul style="list-style-type: none"> <li>• Maintains status quo</li> <li>• Ability to phase in expansion space</li> <li>• 7-year term increases 816 Landlord TI allowance</li> <li>• Provides stability to IMD</li> <li>• Ability to attract and retain IMD employees</li> </ul>	<ul style="list-style-type: none"> <li>• Follows current plan</li> <li>• No risk or cost of sublease</li> <li>• Ability to provide growth/swing space for RR at Indeed Tower</li> <li>• Ability to attract and retain IMD employees</li> <li>• Confidential information related to this decision</li> </ul>	<ul style="list-style-type: none"> <li>• Maintains status quo</li> <li>• Ability to phase in expansion space</li> <li>• Provides stability to IMD</li> <li>• Ability to attract and retain IMD employees</li> </ul>	<ul style="list-style-type: none"> <li>• Maintains status quo</li> <li>• Ability to phase in expansion space</li> <li>• 10-year term increases 816 Landlord TI allowance</li> <li>• Provides stability to IMD</li> <li>• Ability to attract and retain IMD employees</li> </ul>
Considerations	<ul style="list-style-type: none"> <li>• Risk and cost for subleasing of Indeed Tower</li> <li>• Long-term liability associated with Indeed Tower sublease</li> <li>• Lease term requires a termination option for a fee</li> </ul>	<ul style="list-style-type: none"> <li>• Much higher build out cost for new construction space</li> <li>• Rent is \$4.50 PSF more than 816 Congress</li> <li>• Overall SF higher with no phase in available</li> <li>• Perception of a new building</li> </ul>	<ul style="list-style-type: none"> <li>• Risk and cost for subleasing of Indeed Tower</li> <li>• Long-term liability associated with Indeed Tower sublease</li> <li>• Lease term requires a termination option for a fee</li> <li>• Does not solve long term needs</li> </ul>	<ul style="list-style-type: none"> <li>• Risk and cost for subleasing of Indeed Tower</li> <li>• Long-term liability associated with Indeed Tower sublease</li> <li>• Lease term requires a higher termination option for a fee</li> </ul>
Present Value of Savings Compared to Indeed Tower	<ul style="list-style-type: none"> <li>• \$9.1 million</li> </ul>	<ul style="list-style-type: none"> <li>• N/A</li> </ul>	<ul style="list-style-type: none"> <li>• \$8.0 million</li> </ul>	<ul style="list-style-type: none"> <li>• \$10.6 million</li> </ul>

# TRS Long Term Facilities

## *Indeed Tower Lease – Subleasing Considerations*

- TRS does not have the unilateral right to terminate the lease
  - TRS would still be obligated to pay rent and expenses for entire lease term
- TRS can sublease the space
  - Any sublease is subject to the Landlord's approval
  - Subleasing is subject to market risk
  - TRS would have to pay the brokerage cost of sub-leasing the space (estimated at 6% of lease obligation)
- TRS would have to pay rent until a sub-tenant is found
  - To remove TRS from the lease obligation, a similar credit tenant would need to be found
  - Subleasing would most likely be in phases, possibly floor by floor
- TRS would share in the benefits if the sub-tenant pays a higher lease rate

# TRS Long Term Facilities

## *Austin Office Market Update*

- Austin has experienced tremendous growth in the current economic cycle, both in terms of population and new jobs
- Demand for office space in Austin remains robust
  - Net absorption in 2019 across Austin was 2.1 million sf, with 622k sf of that total in the Austin Central Business District (“CBD”)
  - Several large users chose to lease office space in both the CBD and in suburban locations such as the Domain
- Vacancy in the market is low, particularly Class A space in the Austin CBD at 5%, resulting in limited options for users with large space needs
- CBD rental rate increases of 18% over the past 2 years
- As a result of strong demand, limited supply, and high rent rates, developers are active in the market with approximately 6 million sf of Class A space under construction and 3 million sf of that space in the Austin CBD
  - Office developments that are currently under construction with delivery dates in the next 1-2 years will benefit from increased demand
  - Tenants with near term space needs have limited options for occupancy

# TRS Long Term Facilities

## *Recommendation and Next Steps*

### ***Recommendation***

- Proposed Board Resolution
  - TRS authorized to negotiate a renewal and expansion at 816 Congress
    - 7 year term with the one-time right to terminate if TRS is consolidated at a new HQ
    - Expand to accommodate Build the Fleet growth
  - TRS pursue the subleasing of existing space at Indeed Tower

### ***Next Steps***

- Continue due diligence on long-term facilities planning
- Provide Board updates on broker and developer finalists negotiations in April and July
- Continue evaluation of Regional Offices
- Seek Board action as appropriate