calottery

MEMORANDUM

Date: November 21, 2013

To: California State Lottery Commission

From: Paula D. LaBrie, Acting Director

Prepared By: Terry Murphy
Deputy Director, Operations

Subject: Item 9(a) – Facilities Master Plan

ISSUE

Should the California State Lottery Commission (Commission) approve the Facilities Master Plan as a guiding document for the California State Lottery's (Lottery) District Offices (DOs) and Distribution Centers (DCs) facilities strategy?

RECOMMENDATION

Lottery staff recommends that the Commission approve the Facilities Master Plan as the Lottery's DOs and DCs facilities guiding document.

BACKGROUND

The Lottery operates a portfolio of leased and owned facilities across the state for different business purposes. These facilities include the headquarters (HQ) campus, two Scratchers® tickets distribution centers (DCs), and nine district offices (DOs). The owned properties include the HQ campus, the Northern Distribution Center (NDC), and the Sacramento DO. The HQ building was completed in July 2011 and serves the Lottery's operational needs; therefore it will be reviewed and evaluated in future Facilities Master Plan revisions.

Several of the Lottery's existing facilities do not meet current operational needs. The Lottery's sales force is growing and business practices are evolving. Additionally, the Lottery projects continued sales increases for several years. As a result, the Lottery needs to develop a Facilities Master Plan that will ensure its current and future needs are met, and that the projects to accomplish this are prioritized and coordinated to ensure efficiency.

The Lottery's Strategic Direction FY 2013-14 through FY 2015-16 – its business planning document that was approved by the Commission – laid out four key themes; one of them relating to infrastructure. That document identified the creation of a Facilities Master Plan to build a long-term vision of how the facilities aspect of the Lottery's infrastructure can meet long-term business needs.

In July 2012, an independent real-estate professional prepared a lease-or-buy analysis for all of the Lottery's leased facilities. The analysis compared the Lottery's leased facilities' operating expenses over 20 years under three scenarios: purchase, current lease, and market lease. The annual and total 20-year costs to the Lottery were calculated and show the Lottery would save over $1 million in annual operating expenses under the purchase scenario versus continuing current leases. When factoring in the future sale of any purchased property, the Lottery would realize greater savings, even if the property depreciated in value. The analysis concluded that even under conservative circumstances there is a clear financial advantage for the Lottery to own its facilities. Additionally, owning provides greater operational flexibility and stability than leasing. Therefore, an underlying assumption of the Facilities Master Plan is that the Lottery should own its facilities whenever feasible.

DISCUSSION

The Facilities Master Plan creates an infrastructure roadmap for Lottery facilities that will maintain and improve ongoing operations. It summarizes current Lottery facilities, defines their strategic purposes and functionality, projects future facility needs, and defines a prioritized list of facilities projects to meet those needs. The plan is organized into two sections: District Offices and Distribution Centers. Any property purchases or contracts of $250,000 and above are subject to Commission review and approval.

District Offices

The DOs are responsible for sales operations, warehousing and distribution, public counter service and promotions, and security and law enforcement operations. This operational model is comparable to many other state lotteries. After evaluating other potential operating models, the current consolidated model, with the four functions maintained in one facility, provides an efficient, effective, and logical approach.

In order to be most accessible to Lottery players and retailers, it is advisable to place DOs near the most densely populated areas of the state. Where two or more high density areas exist but without enough projected growth to support an additional DO, the DO is positioned centrally within the high density areas, which has proven to be an effective solution. The Facilities Master Plan provides that DOs should remain in general proximity to their current locations and sized appropriately to accommodate 20-year growth projections. The Sacramento DO is located in an ideal location, has enough space to accommodate 20-year projections, and is an owned facility.

The following is a general priority list that shows the order in which DO lease-to-own projects should proceed due to factors or constraints that negatively impact operations.

District Office	**Reasoning**
Santa Fe Springs	Lease expires May 31, 2015, and the landlord will not renew; no room for warehousing growth; limited room for personnel growth
Van Nuys	Most constrained facility; no room for personnel and warehousing growth; limited public visibility and accessibility;
East Bay	Inefficient two-story building; no room for warehousing growth; limited public visibility and accessibility
Santa Ana	Limited room for personnel and warehousing growth
San Francisco	Limited public visibility and accessibility; limited room for personnel growth
Inland Empire	Limited public visibility and accessibility; limited room for warehousing growth
San Diego	Limited warehouse access; limited room for warehousing growth; facility meets short-term needs;
Central Valley	Earliest lease out September 30, 2017; limited room for personnel growth; facility meets short-term needs

The size of a Lottery-owned DO facility purchased in accordance with the Facilities Master Plan will vary. Based on space allocation standards, 20-year projected personnel levels, common area factors, and warehousing space needs, the size of DOs will range from approximately 6,500 to 10,000 square feet. Ultimately, a licensed architect with building codes and standards expertise will determine each DO layout based on the Lottery's operational needs.

Distribution Centers

The DCs are the Lottery's supply chain centerpiece and play the important role of warehousing and distributing the products that generate the majority of the Lottery's revenue. Therefore, it is essential that these facilities are adequately prepared to handle the Lottery's projected growth over the next 20 years. Prior analyses have determined that operating two DCs provides improved logistics and risk management, and that owning the DC facilities provides a reduction in operating costs and greater operational flexibility versus leasing.

After analyzing the current utilization and future space needs for each DC, it was determined the Southern Distribution Center (SDC) is too small to meet the Lottery's long-term needs. Furthermore, the SDC includes two separate leased facilities which inhibits efficiency, security, and operational flexibility. Based on the analysis of the SDC contained in the Facilities Master Plan, it is recommended the Lottery procure a warehouse of at least 60,000 square feet. There is no operational reason to relocate the SDC to a different area. Further, maintaining the SDC near its current location will minimize supply chain and personnel disruptions.

The Facilities Master Plan provides that if the Lottery utilizes the entire NDC facility, the NDC is appropriately sized to accommodate 20-year projected growth. When the Lottery purchased the NDC, it leased approximately 16,000 square feet of space to a tenant. The Lottery's lease agreement with the current tenant expires on October 31, 2014. The Facilities Master Plan recommends the Lottery not enter into any new lease agreement after the current lease expires in order to allow enough time to expand the warehouse facility into the currently leased area. The Lottery owns the NDC which provides reduced operating costs and improved facility flexibility compared to leasing a facility. Additionally, the capitalized costs associated with the development of the NDC (racking, Pick and Pack stations, etc.) have been fully depreciated which provides an annual administrative cost benefit. Based on the Facilities Master Plan's analysis of the NDC, it is recommended that the Lottery maintain its current NDC and expand the warehouse facility into the currently leased space once the lease agreement ends in October 2014.

Conclusion
In order to improve operational efficiency and prepare for futures sales growth, the Facilities Master Plan recommends a series of facilities projects to replace leased facilities with Lottery-owned facilities which include eight DOs and the SDC.