

A Public-Private Partnering Approach to GSA's Existing Leases

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President Obama and his new Administration have done a great deal to bring stimulus to our economy. Listening carefully to the President you also hear a message of investing and spending smartly. The various stimulus initiatives are not spending for spending's sake. Rather, the President counsels the country and his Administration to act wisely. This article will focus on an approach that is smart for this market. It is smart for the government as the largest lessee in the country and it is smart for lessors who are facing increasingly uncertain equity and credit markets. Working together in public-private partnering relationships the government and property owners can help stabilize markets and reduce the cost of leased space to the government.

We will use GSA as the example for the principles discussed in this article, but the same approach would be applicable to any agency, civilian or military, with a significant portfolio of leased properties.

The Scale of the GSA Leasing Program

The Federal government, as the country's largest tenant, leases over three-quarters of a billion square feet of space and owns another three billion square feet of space. Of this, the General Services Administration through its real estate arm, the Public Buildings Service, had on mid-May of this year exactly 8,790 leases in over 7,100 buildings totaling 180,635,295 rentable square feet of space. At the very same time, GSA owned exactly 1,500 active federal buildings containing 174,712,173 rentable square feet of space. These figures clearly show that the amount of GSA's leased space has now definitely overtaken and surpassed the amount GSA's owned spaces, and stands at 50.83 percent of GSA's space inventory.

The current gross rental on this leased inventory is now very close to \$4.6 billion, and averages \$25.46 per rentable

square foot per year, nationwide.

What is far more significant, given the present economic environment, is the number of GSA leases that are expiring in the near future. The average lease term of the leasing portfolio when the leases were initiated was 9.1 years. But as of May 15, 2009, the average remaining lease term was just 4.0 years, and the median remaining lease term of the portfolio was just 3.25 years. That is, fully half the leases in GSA's leasing portfolio are due to expire within the next 39 months. A breakdown by expiration reveals that 2,013 leases are due to expire within one year from May 15, 2009; 1,243 more within two years; 843 more within three years; 931 more within four years; and another 796 within five years. This compression has been due in part to the fact that 1,803 of GSA's leases currently represent short-term extensions.

By the way, the above figures are conservative in that the GSA data base shows that there were an additional 197 leases that were due to expire prior to May 15, 2009, whose current status is unrecorded—some of these may have been re-competed and replaced by long-term leases, and some may have been granted short-term extensions.

Just imagine what is going through the minds of the more than five thousand lessors faced with lease expiration within the next four years. Some will not be terribly concerned because government occupancy represents just a very small percentage of their building. But we estimate that for as many as two thousand or more of these lessors, their GSA leases that are due to expire within four years reflect situations where government occupancy is 50 percent or more. (Only an estimate is possible to come by because about 13 percent of the leases in the GSA data base do not specify the percentage of government occupancy.)

For most of these lessors, the possi-

bility that the government will go elsewhere is a serious concern, made even more so because the vacated space will be very difficult to fill with private-sector tenants because of the downturn in commercial real estate that is or will be soon occurring. Faced with such situations, lessors are finding that the financing for sale or modernization are very difficult if not almost impossible to obtain in today's economic climate. This greatly limits options available to them, leaving them vulnerable to threat of default and foreclosure, with consequential loss of equity. Such uncertainty will further disrupt local commercial real estate markets, which is now an important consideration for federal policy makers.

From Process-Driven to Strategic

But here's how things could play out to the simultaneous benefit of GSA, building owners and lenders. Suppose the rental rate the government has been paying for many years is not far from the national average of \$25.46, say \$25 per square foot, and suppose that looking ahead the market rate that GSA would likely pay upon renewal in a matter of months or a very few years would be, say, \$32 per square foot. And further suppose that the government is perfectly satisfied with the space and would not at all mind staying in place. Then an optimal course of action for GSA to pursue is to negotiate for and replace the current lease with a superseding lease for, say, ten years at \$27 per square foot. Doing so would save the government \$5 or so (the difference between \$32 and \$27) per square foot per year over the term of the superseding lease. The cost savings to the government under this scenario can be substantial. For a 50,000 square foot lease a \$5 a year savings over ten years will be \$2.5 million. For a 100,000 square foot lease a \$5 a year savings over 20 years could amount to \$10 million. And that's

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