U.S. General Services Administration

GSA Public Buildings Service

January 27

2010

Financial Lender Symposium

Financing GSA Lease Projects in a Changing Market

General Services Administration, Public Buildings Service

Financial Lender Symposium

"Financing GSA Lease Projects in a Changing Market"
(January 27, 2010)

Meeting Notes

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SYMPOSIUM OVERVIEW

Opening Remarks
Samuel J. "Chip" Morris *(Assistant Commissioner, GSA Public Buildings Service)*

Mr. Morris welcomed the audience and introduced the intent and approach for the Symposium. He emphasized the importance of building better communications between GSA and the private sector, and the potential for identifying ideas and opportunities to address system constraints. He then encouraged everyone to introduce themselves to the GSA and Lender participants at their tables.

Later during the morning session, Mr. Morris introduced Mr. Robert Peck, the Commissioner for the Public Buildings Service. Mr. Peck encouraged the participants to ask the tough questions necessary for identifying real issues and to begin building a foundation of candor in their communications with GSA.

Conference Overview & Organization,
Sam Falcone, *(Conference Facilitator, McManis & Monsalve Associates)*

The facilitator introduced the facilitation team that would be assisting with the session (Sam Falcone, Phil Nathanson, Chad Cressley) and then outlined the specific agenda topics that would be presented throughout the day. Conference ground rules were also covered along with approaches to asking questions and actively participating. Because of the size of the group (over 100 participants), a stack of index cards was placed on each table to allow participants the option of writing questions down and handing them to one of the conference facilitators. GSA staff and facilitation team members would also be available with microphones to provide participants with opportunities to voice questions and comments directly.

The facilitator provided an overview of the agenda and the symposium topics including:

- **How are GSA Leases Different from, and Similar to Private Sector Leases?** (GSA Experts Barry Segal & Denise Broskey)
- **Case Study: Discussing Barriers to Financing & Brainstorming Solutions** (All Participants)
- **Panel Discussion: Perspectives on Financing GSA Lease Projects** (Anita Molino, Bostonia Partners; Tom Zarrilli, CTL Capital; James Smale, GSA; Ray Ritchey, Boston Properties)
- **The Federal Budget Outlook for 2011** (Stan Collender, Qorvis Communications LLC)
- **U.S. Leasing and Capital Market Outlook and Other Influences on GSA Leasing** (Kim Burke & Benjamin Breslau from Jones Lang LaSalle)
- **Building Flexible GSA Leases** (GSA Experts Barry Segal, Denise Broskey, Thomas Tolley, Chris Wisner, & Janise Nichols)

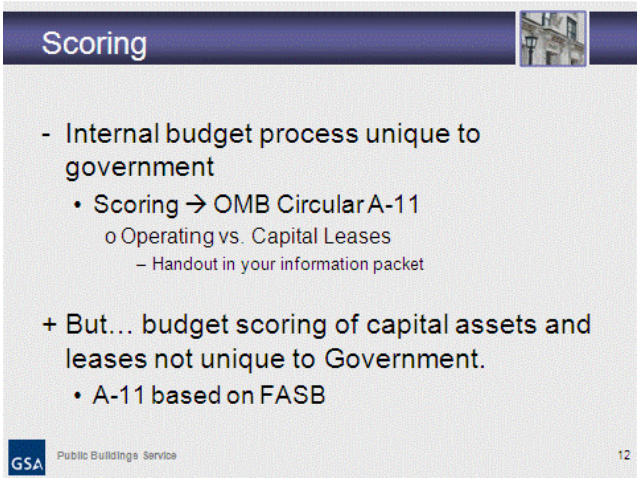
SYMPOSIUM TOPICS AND SUMMARIES

How are GSA Leases Different from, and Similar to Private Sector Leases?

Barry Segal *(GSA)* & Denise Broskey *(GSA)*

The first topic for discussion was presented by GSA experts Barry Segal and Denise Broskey, and focused on the similarities and differences between GSA leases and private sector leases.

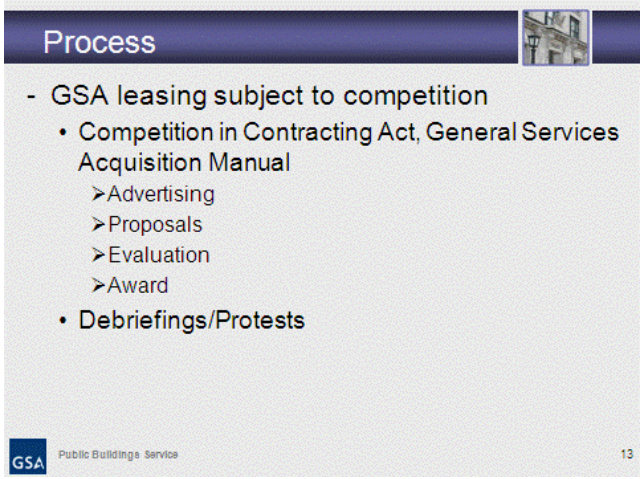
Areas of focus included an overview of the similarities and differences in rent payments and specific forms used—the presenters noted that government rents are paid in arrears and that the forms used with government lease projects are very different than those used in the private sector.



Scoring similarities and differences were also discussed, noting that government scoring was in accordance with OMB Circular A-11, while in the private sector, budget scoring of capital assets and leases was in accordance with Financial Accounting Standards Board (FASB) guidelines.

The importance of achieving a level of comfort and understanding of GSA processes and procedures was also discussed, with a focus on government backed payments, the tendency to extend leases, and the use of brokers.

Several considerations were noted as key drivers of the space GSA looks to acquire. These included the security needs of the client agency and the statutory/regulatory rules governing the agency.



GSA requirements for competition were reviewed along with an overview of the essential business process steps required to achieve a competitive environment.

Condemnations were also discussed and the presenters noted that they are rarely used. Developers and lenders had expressed some concerns in this area.

It was noted that GSA can do leases up to 20 years, but the standard is roughly 10 years. This was a topic which generated group discussion, with longer leases advocated by lender participants.

Case Study Exercise: Discussing Barriers to Financing and Brainstorming Solutions
(All Participants)

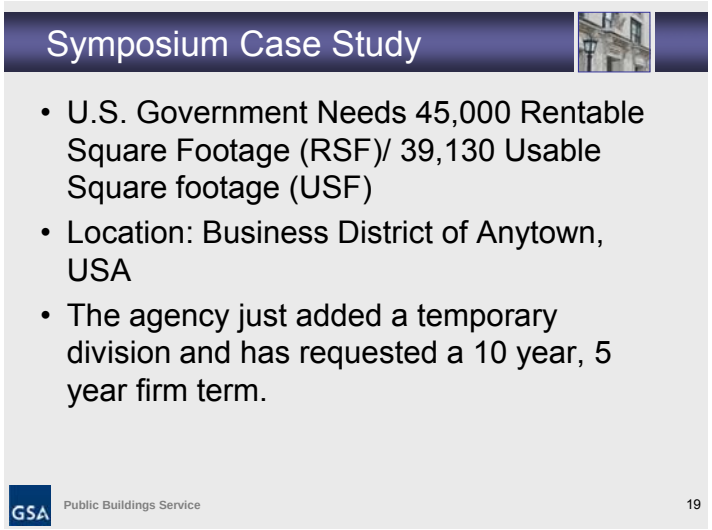
Participants were provided with a case study and asked to work as a team at their tables to identify the key considerations with two hypothetical offeror scenarios. Seating had been set up in advance to blend participants from GSA and the lender community at each table. Each table/group then subsequently addressed five specific case study questions. Representatives from several of the groups were then asked to address and out-brief one or more of the questions. McManis facilitation staff helped with immediate development of briefing slides to assist the volunteer presenters.

The case study scenario is summarized as follows:

Case Study Highlights:
After the ad and market survey the government solicited four locations and two offers were received.

Offeror 1 is offering an existing building on the first floor, located just off of the elevator lobby. The building is 10 years old, Class- A and well maintained.

Offeror 2 is offering a speculative building to meet the Government's requirement. The speculative building has undergone earth work and has poured the slab. The estimated delivery time is around 12 months.



A comparison of the offers is as follows:

	Offeror 1: Existing Bldg.	Offeror 2: Speculative Bldg.
Annual Rent Years 1-5:	$1,528,200	$1,695,600
Annual Rent Years 6-10:	$1,298,250	$1,695,600
Rate per RSF:	$33. 96	$37.68
Shell:	$19.00	$23.00
Operating:	$6.85	$6.75
TI Amortization Rate & Amt:	9.0%, $6.73	8.0%, $6.58/rsf

Participants were then asked to work as a team at their tables to address five questions:

- Question 1: involved identifying key considerations for how the deals were underwritten;
- Question 2: addressed the impact the Fire and Casualty Damage Clause had on financing, where the government may terminate the lease on written notice or reduce the rent by supplemental agreement in case of partial or entire premise destruction;
- Question 3: addressed the impact of the Default in Delivery-Time Extension Clause, and lenders' concerns about it providing termination rights without opportunity to cure;
- Question 4: addressed the advantages and disadvantages of the government's potential issuing of a Turn-Key SFO, where all the requirements are provided in the SFO and the costs are negotiated prior to award;
- Question 5: addressed what documents (in addition to the letter of commitment from the bank) the government might request from the offerors prior to award to qualify their capability to perform.

After working with their colleagues at their tables, several teams were asked to out-brief their results. A summary of their presentations is reflected in the table below:

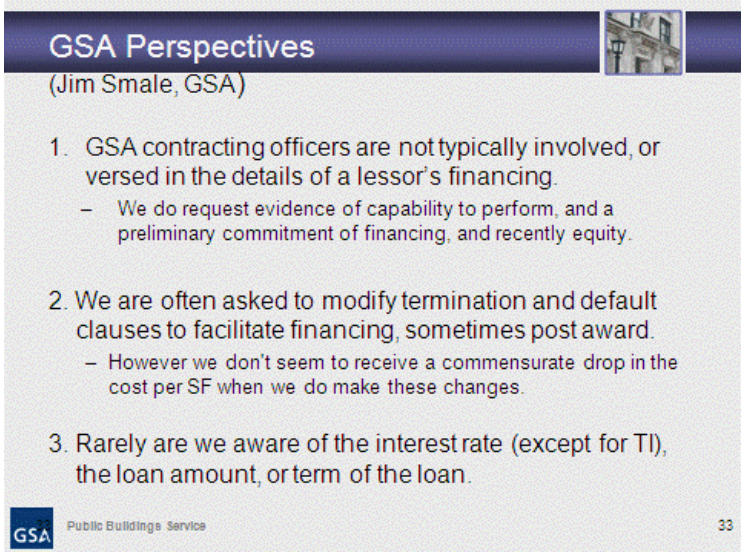
Q1. How underwritten? What's the logic and the numbers of the two offers?	**Q2. How much does the Fire and Casualty Damage Clause affect the financing and the offer price?**
-Cap markets are going to write 5-year with built in extension, not 10-years with a termination. -Offer #1 can propose lower rates because it's an existing building. -Offer #1 is superior because there's no capital risk. -GSA would do Offer #1 in the real world. -Offer #2 is materially more risky; offeror is trying to lay risk off on GSA.	-Any termination clause poses additional risks for equity and debt. -Builder A is offering a lower price than he would have proposed with the clause included in the offer. -We also think he might have no choice whether to strike because of an existing lender. -We're also thinking it's Builder B who should have struck the clause.
Q3. Default in Delivery-Time Extensions	**Q4. Turnkey—Primary Considerations:**
Offeror 1 = Neutral, because that building already exists. Financing is likely already in place. Offeror 2 = Massive risk and the builder would like 3517x, as there would be issues in: -Ability to get a loan, -Loan guarantees, -Delivery guarantees, -Liability (Liquidated damages, Loss of rent, Risk of termination).	-Advantage of turnkey is that it provides certainty to the developer and the lender. -Disadvantage of turnkey involves the change orders after award. -Disadvantage - Need a larger contingency because of some unknowns. - Disadvantage= Higher Cost to GSA. -Critical to communicate requirements clearly up front – need tight drawings and specifications.
Q5 Other Documents to Verify Offeror Capability: <u>In Addition to the Letter of Commitment, verify with the offeror:</u> -Financial statements, -Status of other projects, -Previous experience,-ID the source of equity, -Full disclosure on the deal, -Submission of Final Proposal Revisions (FPR) or close to it, -Major deposit has to be posted, -Disclosure of other lease contracts.	

Panel Discussion: Perspectives on Financing GSA Lease Projects
Anita Molino *(Bostonia Partners),* Tom Zarrilli *(CTL Capital),* James Smale *(GSA),* Ray Ritchey *(Boston Properties)*

After a short break, experts from the private sector in finance and property development joined Jim Smale from GSA in a panel discussion on financing GSA lease projects. Each panelist presented their unique perspective on lease projects while intermittently engaging in rounds of discussion with their fellow panelists.

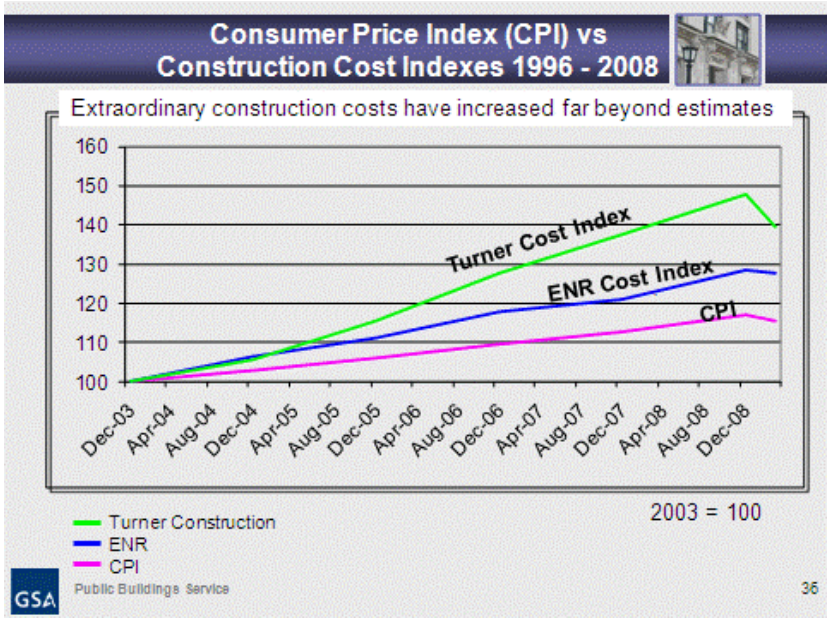
Ray Ritchey from Boston Properties presented the developer perspective and discussed a range of issues, noting that the Washington Region is especially fortunate to have a large GSA presence. He added that GSA Leases were still the gold standard. Mr. Ritchey noted that there remained a variety of challenges with OMB policies, and in demanding accountability from offerors. He proposed several possible solutions while engaging in a spirited discussion of challenges with his co-panelist, Jim Smale from GSA.

Jim Smale then articulated the GSA perspective on financing lease projects. He noted that GSA leases were indeed the gold standard in the market, but that GSA is often told that their clauses negate a lot of that benefit. He added that to date, GSA's history of terminations has been rare, and added that they then sometimes wonder why GSA leases aren't financed at 60 basis points over treasury bills, especially given all the recent junk investments financed on Wall Street before the crash.

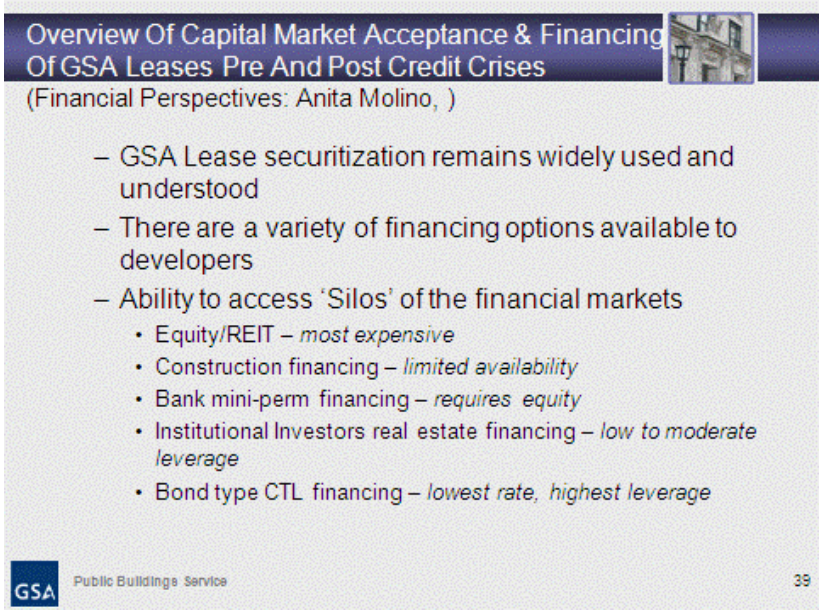


Tom Zarrilli from CTL Capital followed with a discussion of the current economic climate, noting that while interest rates had been heading downward for some time, short term fluctuations in rates have been substantial. These fluctuations can make developer financing difficult.

He also discussed construction cost indexes (Turner Cost Index and ENR Cost Index) in comparison to the Consumer Price Index, noting that construction costs had increased far beyond estimates.



Anita Molino from Bostonia Partners supplemented the discussion of financial perspectives by focusing on financing options available in the market place. She noted that there were "Silos" within the financial markets that could be accessed, each with unique factors to consider. Ms. Molino then focused on strategies for accessing finance from the owner's perspective, and also from the lender's perspective.



The Federal Budget Outlook for 2011
Stan Collender *(Qorvis Communications LLC)*

After the lunch break Stan Collender from Qorvis Communications provided insights on the federal budget looking forward to 2011. He noted that rapid change had become the norm in Washington and that there likely would be multiple initiatives to address budget deficits in the coming months. He added that such initiatives could place GSA under a lot of pressure to create efficiencies, as Federal costs would be under extraordinary review. While indicating he felt increased Federal spending had been needed previously to address the economic crisis, he added that reigning in spending once the economy was on a firmer footing would be difficult. Current deficit numbers and projections discussed are noted below.

- 2008 deficit: $455 billion
- 2009 deficit: $1.4 trillion
- 2010 projection: $1.3 trillion
- 2011 projection (baseline): $1 trillion

U.S. Leasing and Capital Market Outlook and Other Influences on GSA Leasing
Kim Burke *(Jones Lang LaSalle),* Benjamin Breslau *(Jones Lang LaSalle)*

Kim Burke and Ben Breslau from Jones Lang LaSalle presented on the U.S. leasing and capital market outlook for 2010 and 2011. Mr. Breslau noted that the economy does appear to be recovering, but that real estate has lagged other sectors, as is traditionally the case. In addition, he noted that various real estate markets are at different stages in terms of recovery. While most are still in a falling market, the Washington DC and Pittsburgh regions seem to have stabilized. He added that the current recovery (in real estate) is mostly in renewals and not upgrades, and that tenants are just starting to sign long-term contracts.

Based on current estimates, national office real estate vacancy is 18.3% and the presenters believe it will hit 20%. They noted that there would be continued opportunities for tenants to take advantage of the current market.

Forecast and Timeline for recovery:
- 6-12 months until a real turn in occupancy occurs.
- Modest decline in rents in 2010 and maybe 2011 (can vary widely based on individual markets).
- Transaction volume will tick up a little in 2010.
- Should the government be writing longer or shorter term leases based on this? If you don't need flexibility (core real estate) longer term is probably better.

Ms. Burke discussed how current market conditions could influence GSA Leases. She highlighted potential influences on the lease portfolio strategy, noting that changes in market conditions that affect price will impact decisions on space and location, as reduced rental rates offer opportunities for cost savings. She added that the elevated vacancy in leased buildings offers consolidation opportunities for the government.

In terms of procurement of leased space in existing buildings there were greater options to use market leverage to secure concessions and options. Regarding procurement of lease-

construction projects, she noted that creditworthy tenants can now more easily secure financing, but that projects located in major markets may see more competition.

Ms. Burke then compared operating lease criteria from the OMB perspective with that of the private sector as guided by Financial Accounting Standard 13. The table below summarizes this comparison.

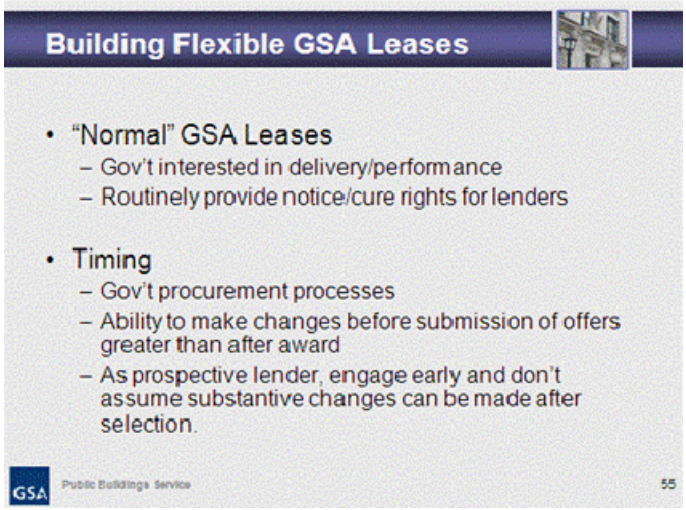
OMB Scoring Rules for Operating Leases (Circular A-11, Appendix B)	Parallel Criteria	Private Sector Rules for Operating Leases Financial Accounting Standard 13
Ownership resides with lessor and is not immediately transferred to government at the end of lease term	☑	The lease does not transfer ownership of the property to the lessee by the end of the lease term
No bargain purchase option	☑	No bargain purchase option
Lease term ≤ 75% of economic life of asset	☑	The lease term does not equal 75% or more of the estimated economic life of the property
PV of lease payments ≤ 90% fair market value (renewal options included)	☑	PV of minimum lease payments at the beginning of the lease term does not equal or exceeds 90% of the fair market value of the property
Asset is general purpose in nature – *"If the project is constructed or located on Government land, it will be presumed to be for a special purpose of the Government"*	No	None
There is a private sector market for asset	No	None

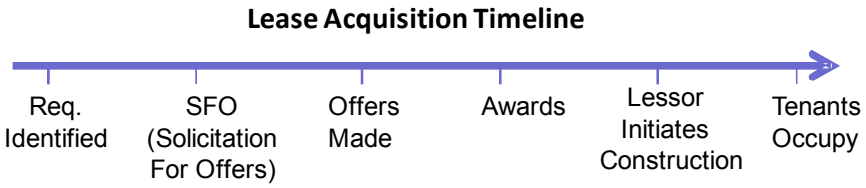
Building Flexible GSA Leases
Barry Segal, Denise Broskey, Tom Tolley, Chris Wisner, and Janise Nichols
(Experts with the GSA Team)

Experts from GSA discussed historical perspectives in approaching leases as well as current initiatives for creating greater flexibility in GSA Lease projects. Barry Segal opened by discussing the historical perspective of Federal Financing Bank Projects and how this approach was used in the past to finance government owned buildings. He noted that the San Francisco Federal Building was the last of these projects funded via this mechanism. He added that because the Balanced Budget Act of 1990 ended the authority to finance projects through this approach, there was now greater emphasis on lease projects.

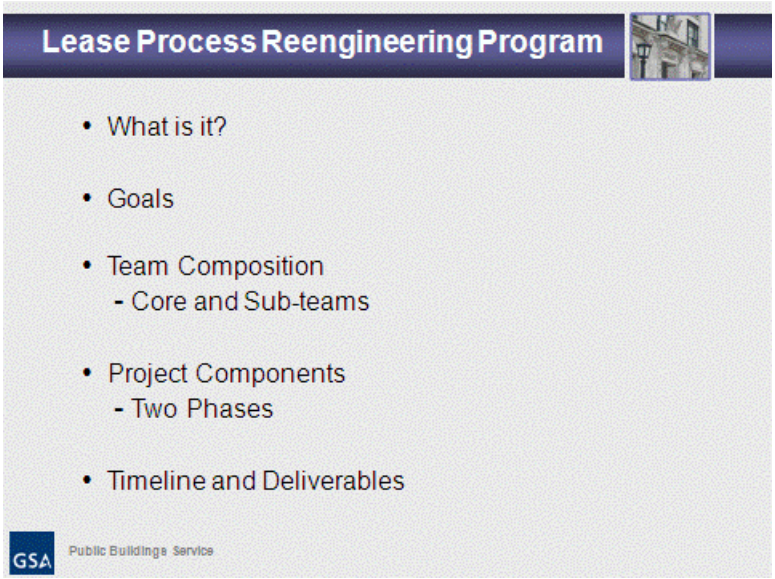
The Patent and Trademark Office (PTO) Project and the Department of Transportation (DOT) Project were then discussed as examples of two projects that involved securitized bond financing. These projects involved a base rent that was non-interruptible during the firm term, and included liberal notice/cure rights for lenders, as well as government monetary recourse limited to the service reserve account. In both of these projects there were market driven forces that affected the leases, with interest rates moving away from and towards GSA. However, GSA was able to remain fairly flexible and meet the demands imposed by the interest rates. In the DOT project the interest rates moved toward the government and the borrower, thus allowing over financing of the lease.

In terms of building greater flexibility in today's GSA lease projects, it was noted that the requirements of government procurement make it easier for GSA to implement changes/flexibility early in the process, and much more difficult to make changes later or post award, as illustrated in the lease acquisition timeline noted below. For this reason it was advantageous for prospective lenders to engage in the process early.





Denise Broskey continued the discussion by following up the review of the lease acquisition timeline with an overview of the GSA Lease Process Reengineering Program.



Sponsored by Commissioner Peck, the program focuses on streamlining the GSA lease acquisition model in order to:

- Simplify process and policy,
- Make it easier for the private sector to work with the government,
- Uncover new or improved methods to increase productivity,
- Enhance project delivery,
- Meet customer expectations, and ultimately improve overall leasing program performance.

The primary goal of the program is to develop lease acquisition processes that are less complicated, standardized, and streamlined, and that balance national consistency with appropriate allowances for flexibility. The team is composed of core teams and ten sub-teams examining the following:

- Scoring, Prospectus Packages, and Pricing Policy
- Streamlining of the TI SFO
- Simplified Lease Acquisition and Accelerated Lease Models
- Succeeding and Superseding Procurement Models
- TI/Post Award Process
- Customer Connection
- Acquisition Planning Process
- Project Tracking
- Seismic and Fire Life Safety Requirement Revisions
- Rent Bill Management Process Improvements

Project components involve the current end-to-end leasing business process and will be addressed in two phases. In Phase I the project team will identify and recommend opportunities relevant to overall lease acquisition processes with a heavy emphasis on the ten major areas of focus mentioned above. In addition, we will begin the process to develop a new real estate project team structure.

Phase II will involve prioritization, further development, and implementation of the improvement recommendations made in Phase I. It will also include finalization of the new real estate team structure, and an examination of additional improvements in HR training and information technology.

Tom Tolley followed with a review of statistics that illustrated the consistency of GSA leasing. A notable statistic was that GSA tenants stay in each square foot of rented space for roughly 26 years (weighted average by sq. ft.). Additional statistics reflecting stability and opportunities were also presented and are summarized below:

2008 Trends	Eight Year Average
– Active Leases = 8,468 – Rentable Square Feet = 174,787,967 – Leases That Did Not Reach the Firm Term = 16 – Leases Terminated During the Non-Firm Term = 99 – Leases Extended Beyond the Initial Full Term = 1,677 .	– Lease Occupancy Stay = 16.9 Years – Inventory Turn-Over on a Lease Basis = 5.9% – Weighted Avg. Stay by Square Footage = 26.3 Years – Inventory Turn-Over on a SF Basis = 3.9%

Chris Wisner then added to the discussion of building more flexible GSA lease projects by reviewing and addressing lender input gathered prior to the symposium. Lenders indicated they wanted firm fixed start dates for projects, firm terms greater than 10 years, and negotiable general clauses.

Regarding firm fixed start dates, while GSA cannot commit to firm dates, lender concerns may be mitigated by GSA's work with customers to bring a more fully developed set of requirements to market. In addition, current efforts to reengineer the lease process to improve time, money and resource efficiency, as well as GSA partnering with developers to streamline design and construction phases may improve transparency and lender ability to assess opportunities.

Lenders also indicated a desire for firm terms greater than 10 years. When feasible, GSA can address this by working with government clients to develop realistic firm terms, and can advise clients to look beyond immediate requirements to take advantage of market opportunities that may have longer term benefits for their organizations. GSA can also help to improve lender comfort with GSA leases by sharing the portfolio history with the lending community so they can get a better sense of the history and stability of GSA leases. Regarding lenders' preferences for negotiable general clauses, it was noted that some clauses are negotiable in cases where trade-offs occur.

Pre-seminar focus groups with lenders also indicated that credit was available for the right combination of revenue stream/risk, developer/owner profile, and GSA Contracting Officer.

Leasehold statistics were reviewed as part of the discussion, and are presented below for the 2010-2012 timeframe:

In the Pipeline 2010 – 2012:

- 3,688 Expiring Leases * 63.2 Million Square Feet*
- 62 Active Lease Construction projects in various stages of the procurement cycle

(* Figures exclude 4.1 million RSF in 479 short term Census leases expiring 2010-2012)

To conclude the discussion of building flexibility in GSA leases, Janise Nichols provided participants with an overview of the role of the PBS Industry Relations Division. She highlighted Division functions specifically with regard to serving as a liaison between PBS offices and vendors, and its ability to educate vendors on how to do business with various parts of PBS. It was noted that part of the outreach effort would encourage mutually beneficial relationships between PBS and major professional associations.

The central email to the Division is: industryrelations@gsa.gov. The Division Call Center can be reached at 1-800-PBS-VEND to answer vendor questions

Open Mic with Participants

After the discussion on building flexible GSA Leases the floor was opened up to questions from the audience. Some audience members inquired how GSA would communicate with them following the seminar and how issues should be addressed. GSA staff noted that the symposium website would be used to continue posting information about follow-up activities and next steps following the symposium. Audience members posed additional suggestions and questions as well including:

- A suggestion to bring the financial advisory function to GSA's side during negotiations.
- Establishing a liaison outside of the contracting officer to help lessen the load.
- Focusing greater attention and flexibility on post-award changes—as lender focus on the lease/project increases after virtually everything is complete.
- GSA staff noted they would like to conduct lessons learned sessions with the developers to expand insights into improving business processes.

SYMPOSIUM FOLLOW-UP/ NEXT STEPS AND CLOSING COMMENTS

Follow-Up/ Next Steps

Over the coming months the GSA Team is planning a variety of activities designed to continue building project flexibility, greater dialogue, and improved understanding between lenders and GSA. Areas of focus will include

- Communication planning involving:
  - Partnering with Industry Relations to continue the dialogue with lenders
  - Posting updates on the GSA website
  - Continued utilization of the Lender Symposium mailbox

- Considering revisions to General Clauses, and linking these to the re-engineering effort. Clauses being focused on may include:
  - Fire & Casualty
  - Default in Delivery
  - Subletting and Assignment

- Establishing a Webinar/Regional Road Show approach that:
  - Takes the message to the GSA regions
  - Demonstrates to lease contracting officers how analysis and understanding of financing and its drivers will improve negotiating competitive lease rents and successful project delivery
  - Uses lender volunteers to help spread the message

Closing Remarks

Samuel J. "Chip" Morris *(Assistant Commissioner, GSA Public Buildings Service)*

Mr. Morris thanked the GSA team who planned and orchestrated the event, and thanked the participants for attending. He emphasized the importance of creating and implementing additional channels of communication that could be used to continue the positive dialogue initiated by the symposium.