The Benefits of Longer Firm-Term Leases

PBS Customer Forum

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GSA

Agenda

- Quotes from PBS Commissioner Dan Mathews
- Data on Lease Terms
- GSA Decision Matrix (Term Setting Tool) on Longer Firm Terms
- Factors GSA Considers When Setting the Lease Term
- Types of Occupancy Agreements (OAs)
- OA Term vs. Lease Term
- Importance of Firm Term
- Stats and Examples
- Summary
- Q&A

PBS Commissioner Mathews on Lease Terms

- “The average amount of time a ***Federal government tenant stays in leased space is roughly 23 years***,” Mathews said, “but the GSA only ***signs leases with average terms of about 6 years***.
- These short-term deals mean the ***government is paying higher rates*** and ***getting fewer incentives*** …”
- "If anything, I really learned over the years that is really the ***most powerful tool*** [long-term leases], more powerful than shrinking the footprint…”

PBS Commissioner Mathews on Lease Terms (con’t)

- "If there’s one change that I’ve been pounding into GSA since I got there, when we think we have a ***long-term requirement***, we need to look at replacing those leases with ***long-term leases***.“

- “Many of those lease expirations are the result of short-term extensions, a practice GSA has struggled with over the years, and ***longer-term deals will give the Federal government more negotiating leverage*** over private landlords. They also ***help landlords to line up financing or invest*** in their properties, creating more potential benefits for the Federal government.”

Agency Reform Plan Initiative

- Longer term leases is on GSA’s Agency Reform Plan
  - High Visibility
  - Being focused on by senior leadership
- Recent GSA Reverse Industry Day
  - Market demanding longer term leases

Data on Lease Terms

- The original, average full term of our current entire lease inventory is 6.9 years
- GSA customers remain in the same location for a weighted average of 21.6 years
  - Why is there a 14.7 year disconnect?
  - Are we missing out on substantial value by procuring unnecessarily short lease terms?

GSA Decision Matrix / Lease Term Setting Tool

- Decision Matrix (Lease Term Setting Tool)
  - GSA uses a national decision matrix, or a lease term setting tool, to help standardize our approach to setting a lease term

3 Goals: Decision Matrix / Term Setting Tool

- Obtain lower rental rates by better leveraging the Government's financial strength and its 20 year lease acquisition authority by entering into longer firm term leases where appropriate.
- Reduce the burden of leasing workload on government agencies through the use of longer firm term lease strategies.
- Implement these strategies in a manner that does not result in a material increase in government risk or vacant leased space

Sample Matrix Considerations

- Does the utilization rate meet approved targets?
- Is the lease a core location for the customer?
  - Regional Headquarters or Field Office
- Is the customer spending substantial funds to customize the space?
  - Return On Investment (ROI) related to tenant improvements?
- Is there a strong likelihood of another agency backfilling the space should the Occupancy Agreement (OA) be cancelled?

Each Project Is Unique

- Setting the lease term is an art, not strictly a science
- No magic formula or algorithm
- Input and intel from GSA and you, our customer, are imperative to making the right decision

When to Consider *Avoiding* a Longer Term

- Projects where capital lease scoring is triggered
- A specific alternative housing solution for the long term has been identified
  - Relocation to a Federal building
  - Consolidation with another lease
- Where the risk of sustained vacancy is much greater due to limited/smaller market
- Ultra-competitive markets where Lessors are seeking higher rates for longer terms because rates are expected to continue to rise
- Other situations as determined on a case-by-case basis

Cancellable OA vs. Non-Cancellable OA

- A ***cancellable OA can be terminated*** by a customer agency at any time with 120 days notice (after being in the space for 16 months) with some liability
  - 7% PBS fee
  - remaining TI balance
  - prorated value of any rent concessions

- A ***non-cancellable OA cannot be terminated*** before the expiration date
  - 5% PBS fee

Occupancy Agreement (OA) vs. Lease

- The OA is the agreement between a Customer Agency and GSA
- The Lease is the binding agreement between GSA and the building owner/Lessor
- OA Term vs. Lease Term
  - Do ***not*** have to match
  - Lease term strategy is GSA’s decision
  - OA term is variable
    - OA Internal Concurrence Memo - (for GSA use)
    - Signed by both regional realty and portfolio directors when OA and lease term do not match

Firm Term Importance

- Firm Term is the key to savings with Lessors
- 10 year lease, or even a 20 year lease, with only 5 Firm has minimal benefit
  - The Lessor is unable to pass on favorable pricing
    - Causes difficulty when financing or refinancing
    - Banks care about what’s guaranteed – only the ***Firm Term***
    - Building valuation is focused on firm term
- AAAP data backs up that ***Firm Terms*** matter!
  - Best pricing with AAAP offers are those with the longest firm term

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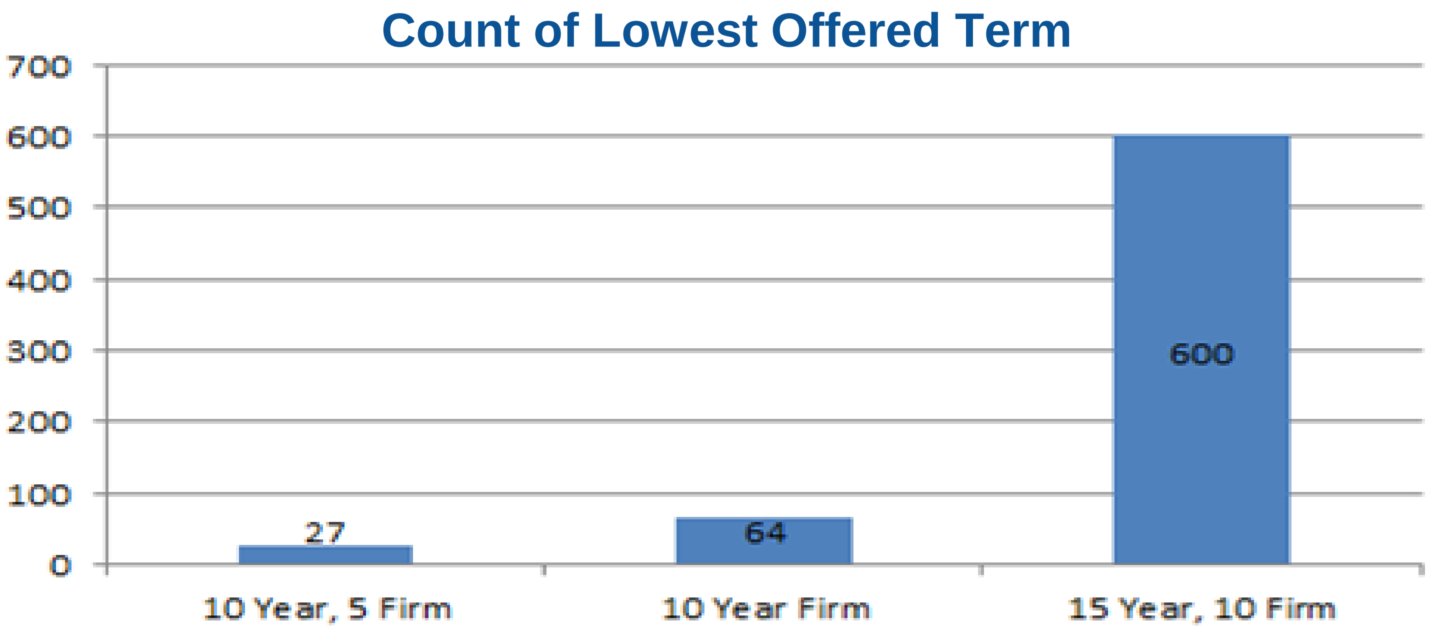
Characteristics of the Soft Term

- Lease terms do not need to be 5 or 10 year increments
  - They can be any duration that creates the most value and complies with scoring guidelines
- Purpose of Soft Term
  - Provides the government flexibility to move and terminate near the end of the lease
    - Is 5 years of flexibility useful to the government?
      - There is a cost associated with Soft Term
- How often do we use it?

Automated Advanced Acquisition Program (AAAP) Term Comparison



Of the AAAP submitted buildings, offers with a 15 year, 10 firm term had the lowest offered rate 87% of the time

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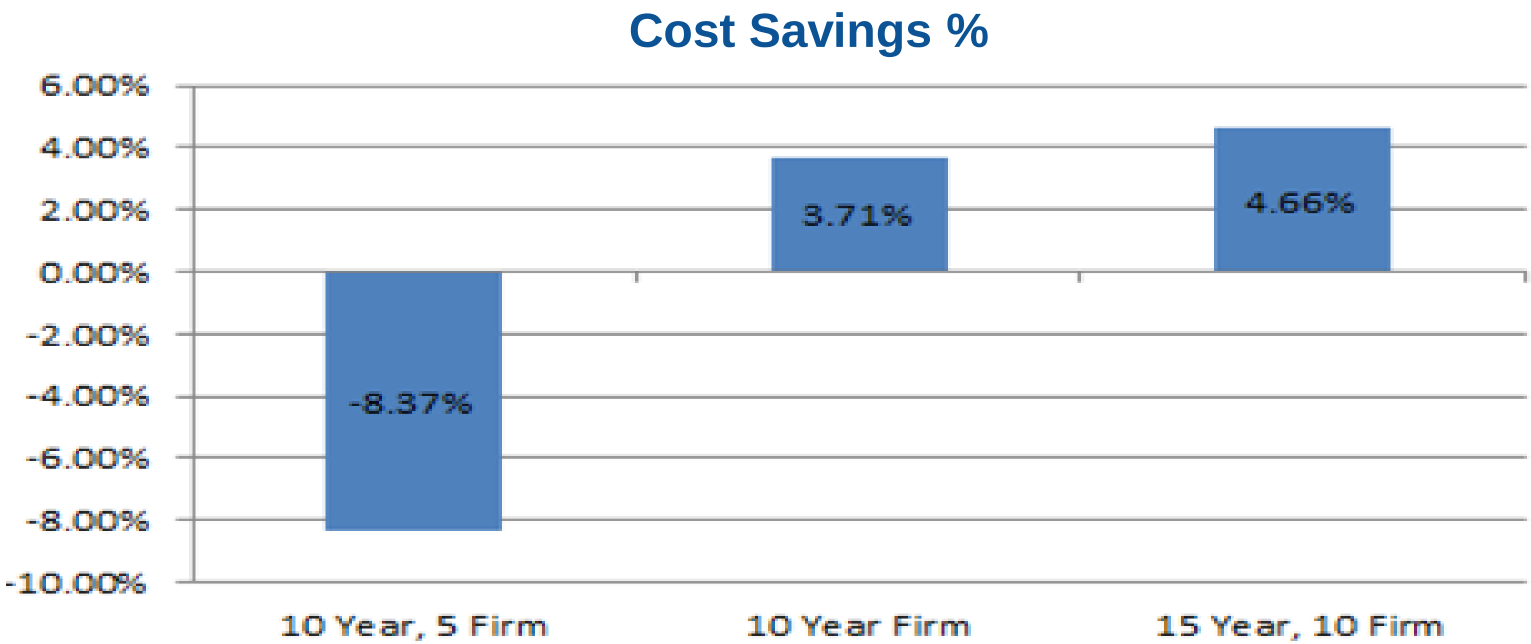
AAAP Rate Comparison



Of the AAAP submitted buildings,
lower rates are offered with longer firm terms

Starting in FY19

AAAP Lease Terms starting in FY19:

1. 17 years, 15 years firm

2. 15 years, 13 years firm

3. 10 years, 8 years firm

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Lease Term Statistics

- GSA has been increasing its use of longer firm terms (10 years or more) in the past few fiscal years
  - FY14: 19% of GSA’s leased inventory had a firm term of 10 years or more
  - FY17: 26% of the leased inventory had a firm term of 10 years or more

- GSA doubled the percentage of leases with a firm term of 15 years or more over the same period
  - From 3% to 6% of the inventory

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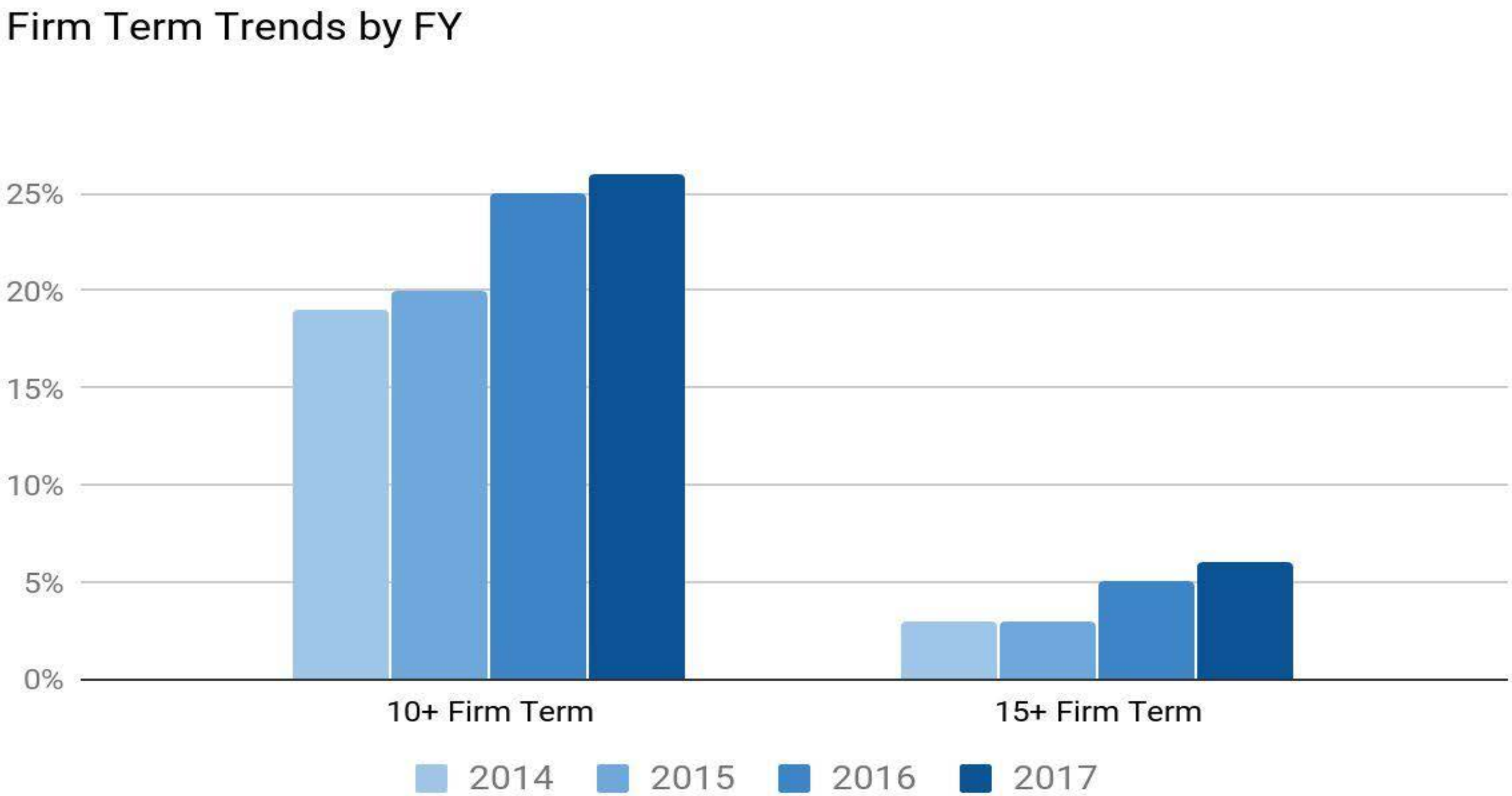
Data: How is GSA Doing So Far?



Example 1

- Agency X Field Office
  - 150,000 RSF
  - Adequate U/R
  - Highly specialized buildout
  - In a market where there is potential backfill
- Lease Term Strategy
  - Firm term for as long as scoring would allow
    - 20 year firm term, ***or***
    - 15 year firm term with a 5 year evaluated/priced renewal option, ***or***
    - 20 year lease, with 18 years firm, *or*
    - Other strategies

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Example 2

- Agency Y office requirement
  - 15,000 RSF
  - U/R meets agency target
  - Agency Y not confident in the future of their mission
  - Located in Atoka, Oklahoma
  - Only Federal tenant in town
- Lease Term Strategy
  - Firm term of 7 years with two, 2 year evaluated/priced renewal options, or 10 year, 8 firm, etc.
  - Other strategies

Summary

- Administration strongly supports GSA doing longer firm term leases where it makes sense
  - Longer term leasing is now part of GSA's Agency Reform Plan
  - Longer term leases help leverage the government's buying power
  - Firm term holds the real power
  - Soft term is costly and rarely used
- GSA's customers tend to remain in the same location for a weighted average of 21.6 years
  - Current average lease term is less than 7 years
- GSA uses the Decision Matrix/Term Setting Tool to help standardize the methodology for setting lease terms
- OA term doesn't always have to match the lease term as decided by GSA
  - Requires high levels of approval

The Benefits of Longer Firm Term Leases

Questions?

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