

Marcy Owens Test

Senior Vice President

CBRE, Inc.

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“Federal Real Estate Post-COVID-19 Part One: A View from The Private Sector”

Thank you for inviting me to share the knowledge and experiences of the commercial real estate industry. I submit this testimony as an individual and not on behalf of any group or organization. The opinions expressed are my own and not necessarily those of my employer, or any other group, organization and/or governmental entity or agency I reference.

#### Background and Experience

I have worked in the industry for 32 years and am currently a professional at CBRE, Inc., the world’s largest commercial real estate services provider. Within CBRE I am a member of the Federal Lessor Advisory Group (or “FLAG”), a team of professionals that specialize in representing private sector owners, investors and developers on real estate transactions where the federal government seeks to lease office, warehouse, laboratory, or other spaces using the government’s procurement methodologies. The FLAG team specializes in understanding the federal government’s real estate needs and translating those needs into a private sector context to help our clients to provide the Government with the highest quality technical and financial solutions to meet their real estate space needs. Different groups within CBRE also represent the federal government in many capacities working with numerous large and small federal agencies over the

years, branches of government, and independent agencies providing brokerage services (lease/lessor/purchase/sale), property management, construction management, valuation services, and many other service offerings. CBRE has a deep and thorough understanding of the public sector proudly representing the government and private sector clients in the federal real estate space.

In addition, I serve as a member of the Board of the National Federal Development Association (“NFDA”). NFDA is a national association of private property owners and service providers who lease space and provide commercial real estate services to federal government tenants. NFDA is a clearinghouse of knowledge, innovations and information developed by experts for experts in the government leasing space.

#### Purpose of this Testimony

With that background, I am here to share insights I have learned from the private sector’s experiences with COVID-19 and return to the office; some history on the reducing federal real estate footprint; concerns that federal real estate Landlords are expressing; and, how planning and collaboration between the Government and the private sector can bring cost effective outcomes to both parties.

#### Private Sector Experiences with COVID-19 and Returning to the Office

The private sector real estate community has been struggling with the considerable uncertainty caused by the pandemic, but we are beginning to see private sector tenants declaring dates for returning to the office. The commercial real estate industry is populated largely by

optimistic people – people who see future opportunity to improve the built environment and the impact a great built environment can have on people’s productivity and work outcomes. The future brings possibility and promise for ways to make a difference in the lives of people using real estate to meet their goals and missions. This last year has challenged even the most optimistic of us as the industry has been forced to take a completely new perspective on how work is performed and the value of the built environment to bring people together.

Today, private sector companies are beginning to bring people back into the office over the next few months, after working remotely for the last 15 months. One measure, according to the Kastle Systems Back to Work Barometer<sup>1</sup>, from data collected from security card swipes from their partners, as of the week of May 10, 2021, a 10-city average occupancy is up to 27.1%. Full return-to-the-office plans seem to be impacted by where the parent company is headquartered, as geographic differences seem to influence the need for a collective environment and as well as company culture. There is survey data and anecdotal evidence that remote work strategies will be in place for the foreseeable future with many private sector tenants waiting until employees return to the office to best assess workplace strategies that may have more of a long-term impact on the use of real estate. There are many examples of downsizing and restructuring of leases with heavy emphasis on short-term lease renewals to give private sector companies time to evaluate the way employees are working and what kind of office space will best support productive employees in the post COVID environment. Examples also exist of government contractors closing offices and consolidating their employees to locations where secure work is required to be completed within a secure office environment. Likely many government

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<sup>1</sup> Reference <https://www.kastle.com/safety-wellness/getting-america-back-to-work/>

contractors will continue to be working from home for the foreseeable future unless government contracts require some minimum amount of work from the contractor's office, which is a consideration as attention is focused on heightened cyber security.

### Federal Real Estate Inventory Reduction

Prior to 2011, the Federal Government had typically focused on delivery of the tenant agency mission and real estate was a means to that end. Cost and quantity of real estate was not a significant focus for measurement. However, following Executive Order 13576 in 2011 which was issued to focus attention on "improving the management of Federal real estate," OMB issued guidance in 2013 to direct federal agencies to implement a "Freeze the Footprint" policy<sup>2</sup> for Federal Real Estate and then again in 2015 to direct federal agencies to implement the "Reduce the Footprint" policy<sup>3</sup>. With leadership from this House Committee, the Executive Branch began its detailed attention on measuring performance for efficiency improvements with utilization rates, or how much square footage per person is leased by the Government. The General Services Administration's ("GSA") lease inventory<sup>4</sup> peaked in September 2013 at more than 198.2 million square feet, and the federal government began focusing on improving utilization in federally owned real estate and reducing its leased inventory. As of GSA's April 2021 inventory, the GSA lease portfolio has been reduced by more than 15 million square feet which

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<sup>2</sup> White House briefing dated March 14, 2013 by Danny Werfel, Controller of the Office of Management and Budget

<sup>3</sup> White House briefing dated March 25, 2015 by David Mader, Controller of the Office of Management and Budget

<sup>4</sup> Statistics referenced are based on the GSA leased inventory database. Recognizing that this only addresses a small portion of the Government's leased portfolio, it is the inventory that is readily available, updated monthly, and is most compatible to investor-grade real estate in private industry. That is not to say that the US Postal Service, Department of Veteran's Affairs, Department of Agriculture or Department of Commerce, for example, do not have investor-grade real estate, but their inventories are not transparent and as available as GSA's inventory.

equates to a reduction of just under 8% since September 2013. 69% of this reduction has been realized in the National Capital Region. Appreciating that the National Capital Region was 29% of the total GSA inventory, it is now 25.7% of the total inventory. And there are many projects planned for large consolidations and relocations into federally owned assets like the Department of Homeland Security into the St. Elizabeth's campus. The "Reduce the Footprint" policy has changed the federal real estate inventory quite substantially.

### Raising Concerns of Federal Real Estate Landlords

All of these events impact the Landlords of federal real estate by undermining confidence in the renewal assumptions of government leases, which are a critical component of the underwriting and financing of commercial real estate. Confidence of tenants' renewal probability is a cornerstone of what drives the best financing and values of federally leased assets. The Government gets good quality space to meet its requirements at the best rates because financial markets value a government lease. The predictability of government occupancy is an important component of the cost of financing and value of federally leased assets and thereby the aggressive rents the private sector is able to offer potential Government tenants.

With some already questioning the value of a lease with the Federal Government due to the pre-pandemic push to downsize the Federal footprint, the next question is how will the effects of COVID-19 on the built environment further impact the federal footprint. Following the last many years of Government space reduction many Landlords in the federal real estate space question what the next 3 to 5 years hold for the federal real estate footprint and if the policies that have helped the Government negotiate many tenant favorable leases will continue.

The commercial real estate market over these last few years has favored the tenant versus the Landlord in most of the country. The Government tenant has been, and will continue to be, in a position of strength at the negotiation table, and their policies to take advantage of the market have been well executed. In particular, the policy to pursue longer lease terms (longer number of years of firm term) with limited soft term, being the portion of a lease term that can be cancelled, has been very successful. For years, the private sector has explained that the Government could negotiate better lease rental rates with longer lease terms and the Government has had good results from utilizing a policy of pursuing longer lease terms when it makes sense to do so.

Through the last year, GSA has been very active in the market. As an agency with legacy remote work strategies, GSA employees transitioned to the mandatory remote work directive very effectively and the private sector saw an increase in the number of lease requirements advertised year-over-year 2019 to 2020. In other words, 2020 was a very productive year for GSA real estate activity. This was a very beneficial year for the Government to negotiate aggressive rental rates and the commercial real estate market has been interested in pursuing government requirements while many private sector tenants negotiated short term renewals or decided to wait until employees return to the office to make long term real estate decisions. This tenant-favorable market is likely to continue in many markets across the country and the Government should be able to take advantage of that with longer term lease requests to the market.

With all of this, many industry folks are feeling concerned and hesitant about how federal real estate will be impacted now that so many employees have been working remotely. There is

a good deal of trepidation that the Government will cut office space without thoroughly reviewing the needs of the mission and the employees for the long term. This growing sentiment is not great for either the industry or the Government because the Government benefits from the confidence it has previously provided the private sector landlord community. If it wants to maintain its favorable negotiating position, the Government will need to continue to reinforce the confidence it provides to private sector landlords by continuing to actively pursue new long-term leases. However, there are already examples of leases expected to expire with no renewal plans, albeit smaller offices in urban centers where employees can be consolidated in other locations, and this continues to concern the federal real estate Landlord community.

Future workplace determination for the Government is a complex issue. It takes time to evaluate federal real estate requirements and budget for the costs associated with changes in space requirements. It will take time and investment in the physical environment and technology infrastructure, just like the private sector is experiencing now. Like the private sector tenant community is learning, understanding occupancy levels as employees return to the office will be part of the information gathering effort. There is no one-size-fits-all solution and federal agencies continue to demonstrate that they have different cultures and different needs for remote work versus fixed attendance. GSA and federal agencies will need to move slowly as they start to understand future work requirements. There are examples of that kind of study and analysis across the federal real estate industry and the Landlord community is looking to be engaged in collaborative and creative solutions with federal agencies just like the private sector is experiencing. Quick action based on limited information may ultimately do more harm than good with inefficient spending and lack of planning.

Just like when the “Freeze the Footprint” policy was issued, federal agencies learned that changes to federal real estate requirements cost money upfront – with the hope that the upfront investment will result in long-term real estate reduction and future annual cost savings. However, without careful planning, the result may be just the opposite, increased costs now and increased costs later. Any changes to workplace strategies and real estate requirements will cost money, some of which comes from the Landlord and some comes from the tenant. This is one area that requires planning for the Landlord as well as the Government and the Government should consider more flexibility with amortization of additional costs into the lease. Currently, one area of the leasing process that requires improvement is the space design and alteration process where the Government expects the Landlord to front load large sums of money without planning or payment. This has been a significant problem for even the most financially stable landlords and will only get worse if GSA expects Landlords to bear all of the cost for the transition to a post COVID environment, especially if that transition is not well thought through and undermines confidence in the Government as a long term tenant.

#### Planning and Collaboration Provide the Best Results

We often get asked to look into our crystal balls to predict future real estate needs. Where will the Government be in 5 or 10 years with respect a particular asset or portfolio? Some have suggested that draconian cuts in the leased federal real estate are coming. However, we have been working in the federal real estate space for a very long time and understand a few key attributes worth pointing out:

- Federal agencies are all different, have many different real estate requirements and will continue to have different requirements after returning to the office.
- It takes a long time to implement any real estate strategy. The reason we are 10 years into the cycle of space reduction is that leases take time to expire and strategies take time to implement. We have at least another 5 to 7 years for the “Reduce the Footprint” policy to be implemented through the full portfolio.
- Much can be learned through collaboration with the private sector which has the resources, expertise and financing available to help the Government execute real estate plans.
- Leasing is a critical component of the Government’s federal real estate strategy. Leasing provides the Government access to flexible, high quality real estate in locations of its choice.
- The Government understands that the leasing effort is a two-way street and that there are ways the Government can help the private sector while the private sector responds to the Government’s specific and unique needs.
- The private sector can pivot faster and address critical directives by the federal government such as addressing sustainability and COVID safety and cleanliness requirements.

Just like with security requirements implementation after the Alfred P. Murrah Federal Building bombing occurred in Oklahoma City and the handicapped accessibility requirements before that, the private sector Landlord community has access to resources, expertise, and capital to implement new government requirements. The private sector Landlord community

will continue to partner with the federal government to provide the best commercial real estate solutions to meet the government's requirements and we hope that the Government adopt policies that will look to solve complex problems with even more of the private sector's involvement.

Thank you for this opportunity.