The Agency Imperative to Manage Real Estate More Effectively

By Norman Dong and Robert Peck

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Overview

In March, Congress approved appropriations bills to fund the Federal government for the remainder of FY2024. In a break from the past, where many agencies have seen increases in their annual budget from one year to the next, the enacted budget for FY2024 was largely flat compared to the prior year. Notably, the budgets for several agencies – including FBI, ATF, EPA, and IRS – were actually reduced in FY2024. One key factor is the Fiscal Responsibility Act of 2023, which establishes enforceable discretionary spending limits for FY2024 and FY2025. As a new era of fiscal constraint looms on the horizon, Federal agencies can improve space utilization and reduce spending on real estate to help absorb the impact.

The Federal conversation about improving space utilization began more than a decade ago, with OMB directing agencies to "Freeze the Footprint" in 2012, and then to "Reduce the Footprint" in 2015. Since then, there has been a gradual reduction in the total size of the Federal portfolio. However, the Government Accountability Office (GAO) report from July 2023 revealed widespread under-utilization in the Federal real estate portfolio in the post-pandemic era of hybrid work. Although there has been a modest reduction in the total square footage of the Federal portfolio, utilization of Federal space has gotten significantly worse.

Not surprisingly, Congress has sounded the alarm, advancing a flurry of legislation and Executive branch reporting requirements designed to improve space utilization and to eliminate excess space from the Federal real estate portfolio. There have been instances in the past where the Executive branch has failed to take action to shed excess real estate and Congress ultimately stepped in to legislate the outcome it wanted to see. As budget pressures continue to mount and chronic underutilization persists across the Federal portfolio, patience is wearing thin.

Agency Strategies for Space Reduction

There is a clear and compelling incentive for agencies to improve utilization and eliminate spending on rent for space that sits empty. Most agencies pay rent from a general salaries and expense account where all funds are fungible. In cases when rent is paid out of a separate account, agencies have the ability to repurpose any rent savings through a transfer or reprogramming notification. As budgets get tighter, the choice is clear—redirect funds currently spent on unneeded square footage towards critical activities that help agencies meet their mission.

Some Federal agencies have taken a proactive approach to improving space utilization and are redirecting funds previously earmarked for now redundant real estate to more mission critical activities. Specific strategies include:

- ***Leverage Upcoming Lease Expirations***

The expiration of the Government firm lease term provides an opportunity for agencies to right-size their real estate requirements. This could take the form of releasing space upon lease renewal or conducting a full and open procurement for a smaller replacing lease.

For example:

- The U.S. Patent and Trademark Office plans to release two of five buildings from its Alexandria Headquarters Campus upon lease renewal in August 2024. This represents a reduction of 763,000 RSF that will save the Agency more than $30 million in rent costs each year.

- In September 2023, as part of the process to execute a five-year lease extension at its current headquarters location, the Securities and Exchange Commission released almost 210,000 RSF, a 17.5 percent reduction in total footprint.

- As its lease in the NOMA neighborhood of Washington, DC, expires in 2025, the Department of Justice is downsizing the overall space requirement from 576,000 RSF to 465,000 RSF, which represents a reduction of nearly 20 percent.

Exercise the Flexibility of Cancellable Occupancy Agreements

The GSA cancellable Occupancy Agreement (OA) has long been a central element of its value proposition. It allows GSA to provide a form of "insurance" by serving as a clearinghouse for unneeded space and mitigating the risk of any change in an agency's space requirements across the broader portfolio of Federally owned and leased assets. Although GSA issued an Asset Management Alert in April 2023 that required Federal tenant agencies to sign non-cancellable OAs, the GSA policy change focused solely on new occupancies. For existing tenancies where the Agency had signed a cancellable OA prior to April 2023, Federal agencies retain the right to turn space back to GSA with 120 days-notice.

The cancellable OA remains an important tool for Federal agencies looking to right-size space requirements and better utilize space within their existing footprints in advance of formal lease expirations. Recent examples include:

- The Transportation Security Administration identified underutilized space at its Springfield, VA, Headquarters totaling 120,000 RSF (about 19 percent of the original 622,000 RSF space requirement) and was able to backfill one vacated floor with another DHS component in need of swing space related to an in-progress consolidation at another facility. The repurposing of unused space within their existing footprint eliminated millions of dollars in redundant rent costs.

- The Federal Trade Commission gave back 252,000 RSF (about 67 percent of its original 375,000 RSF space requirement) at its leased location in Washington, DC.

Returning unoccupied leased space back to GSA not only creates an opportunity for tenant agencies to reduce rent burden, it also allows GSA to lessen the Federal government's overall financial liability. Most Federal leases contain an Adjustment for Vacant Premises clause that allows for a reduction in operating expenses when the Government vacates all or part of the premises before the lease expires. When the Government vacates space prior to the expiration of the lease term and provided that, the lease contracting officer gives 30 days advance written notice to the lessor, the rental rate and base for operating cost adjustments will be reduced The return of excess space to GSA should not be viewed as shifting costs from one Federal entity to another, but as an opportunity for the Government as a whole to reduce its financial exposure for space it no longer requires.

Consolidating into Federal Buildings

Massive amounts of underutilized space across the Federal inventory suggest that there's a significant opportunity to dispose of unused assets by collocating and consolidating Federal agencies into fewer Government-owned buildings. There are some recent success stories of agencies consolidating into Federally-owned space, but overall, the cost of renovating and modernizing Federal buildings to accommodate agency occupancies from leased space is expensive and the project economics are often difficult to justify when compared to the cost of remaining as is or simply extending OAs in leased space

Given the slow pace of capital appropriations, these projects can take more than a decade to complete. Add to that the complication of bifurcated funding between tenant agencies who pay for TI and GSA who is responsible for core and shell costs, and it's not difficult to understand how inefficient funding quickly translates into years of delay and ballooning project costs. A prime example is the renovation of the Department of Commerce headquarters building – a project that started more than 20 years ago in 2003 and is only on phase 4 of 8, despite $681 million in approved funding. There are numerous opportunities to reduce rent costs through consolidation from commercial leases into Federally owned buildings, but this action is limited by the complexities involved in converting Federal buildings into space that meets contemporary office standards.

Equal and Active Partners

Federal agencies should not pay for space that isn't being used. The extensive underutilization of federally occupied space highlighted in recent reports from GAO and the Public Buildings Reform Board (PBRB) have crystallized just how untenable this approach is for the long-term. There are some compelling examples of agencies that have taken a proactive approach to improve space utilization. The real estate savings can be redirected to support mission critical activities. But success is dependent on agencies positioning themselves as equal and active partners with GSA and demonstrating a willingness to endure criticism from those that would prefer to see the status quo maintained.

Norman Dong is a Partner at FD Stonewater and served as GSA Commissioner of Public Buildings under the Obama Administration.

Robert Peck is a Principal and Co-Leader of the Government + Defense Practice Area at Gensler and served as GSA Commissioner of Public Buildings under the Clinton Administration and the Obama Administration.

For questions about this white paper please contact:

Norman Dong
Partner
FD Stonewater
ndong@fdstonewater.com

Robert Peck
Principal
Gensler
bob_peck@gensler.com

www.fdstonewater.com

www.gensler.com