USAA Real Estate Company

Government Property Transformations 101

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The General Services Administration (GSA) real estate portfolio is undergoing a transformation that has far-reaching implications for government property investors. With over 376 million rentable square feet of owned and leased properties spread across nearly 8,700 active assets within multiple jurisdictions, a number of issues can arise within such a complex portfolio. On June 16, 2015, the GSA commissioner testified before a congressional subcommittee regarding several ongoing projects to improve the Federal real estate portfolio. Two initiatives in particular align with what we are seeing in the marketplace: first, a complete overhaul of the GSA leasing process, and second, the implementation of a space consolidation strategy throughout the GSA real estate portfolio.

An arduous leasing process and a glut of expiring leases have haunted the GSA in recent years. In 2011, there were more than 380 federal leases in "holdover," where the lessee remained in occupancy after the lease expired. In fairness, the number improved recently to just 97 leases in holdover as of 2014, the lowest year-end figure since 2007. With several thousand leases set to expire over the next few years, the GSA is looking to prevent such a backlog from recurring, particularly since the holdover premium is often 20% more than standard lease rates. Going forward, the GSA plans to initiate lease negotiations at least 36 months before expiration, while also pursuing longer-term leases, of at least 10 years, to avoid costly holdovers and extensions.

The GSA's consolidation strategy is having a profound impact on the overall real estate portfolio. In 2014, Congress allocated $70 million for GSA consolidation projects, which reduced the federal footprint by 571,000 square feet. Congress again provided $70 million for consolidation projects in 2015 that should further reduce the footprint by more than 247,000 square feet. Collectively, these projects have saved the government roughly $78 million; therefore, we expect this consolidation trend to continue in the near future.

These initiatives are encouraging for government property investors. To start, we expect fewer leases to go into holdover given the proposed 36-month lead-time on negotiations, and the trend toward longer leases makes the asset class more attractive to investors. On the surface, the consolidation efforts may seem like a headwind for property owners. Instead, the consolidations will likely lead to several new buildings that meet both the business requirement and the government's recent sustainability mandate, such as the requirement for new buildings larger than 5,000 square feet to meet "net zero" energy consumption requirements. In the end, the lease process improvements and space consolidation efforts validate our expectations that demand for high-quality office space from federal tenants should continue to increase over the next few years.

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