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A QUARTERLY JOURNAL FOR OWNERS, DEVELOPERS AND ASSET MANAGERS
OF GOVERNMENT-LEASED AND -OWNED REAL PROPERTY

Editor's Welcome!

This year's series of chapter meeting on the part of the National Federal Development Association (NFDA) kicked off with a meeting of the Greater Southwest chapter held on March 21st at the Four Points Sheraton hotel near the Dallas-Fort Worth airport, under the direction of chapter director Danny Lovell, a partner of the sponsoring firm, Rainier Capital. Over two dozen attendees heard a presentation by Marc Rampulla and Brian Saal of JLL on the National Government Investment Outlook, which was then followed by a presentation by Dennis Eisen on his progress on his ongoing research to establish true ownership of GSA-leased buildings of Tier 1 buildings across the country. A significant take-away from the JLL presentation was the fact that core CBD office cap rates in coastal and primary markets are all now seeing core products transact at sub-5.0 percent levels, with the market areas of Seattle, San Francisco, Los Angeles, Austin, Washington DC, New York and Boston leading the way. Lowest cap rate (meaning most expensive properties) in the nation was New York, with cap rates ranging from 3.75% to 4.40%. New to most was the composition chart of the Committee on Foreign Investment in the Unites States (CFIUS), which surely contributed to the impetus behind the study by GAO on foreign ownership of Federally leased buildings that appears in this issue. Your Journal Editor Dennis Eisen then described his ongoing research into establishing true ownership of Tier 1 GSA-leased buildings in the country, which also appears in this issue.

The next meeting of the Western chapter of the NFDA will likely take place in the month of June in the San Francisco Bay area. Time and place have not yet been set but Journal readers and NFDA members will be notified in due course.

On another important aspect of government real estate is who's controlling the leasing on the government side. As the article by contributing editor Ron Kendall discusses, over the last few years, there has been a little-recognized but wide-ranging consolidation in the federal real estate practice area.

All of us in that practice area are well aware that budgetary considerations have often driven lease-vs-own Federal real estate decisions; what's not so apparent is that these considerations are now driving which agency it is that does the leasing. Please read Ron's article that starts on page 3.

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Twilight of the Independent Agencies: the Ascendency of GSA as the (Near) Sole Purveyor of Federal Leasehold Acquisitions

by Contributing Editor, Ron Kendall

Over the last few years, there has been a little-heralded though wide-ranging consolidation in the federal real estate practice area: leasing is pretty much now the exclusive province of GSA. Or put another way, these days if GSA is not doing the actual federal leasehold acquisition work, then GSA's leasing authority has probably been delegated to the agency, which is self-performing the actual procurement—but under the aegis of GSA. (Notable exceptions: leasing by national intelligence agencies, military department leases in foreign countries, and leases for military family housing.) A case in point is the Department of Veterans Affairs, which for decades has done its own leasing—and is currently in the midst of a robust, multiyear program of lease-construct projects for community outpatient clinics—but now all of these VA leases are being done under delegation from GSA.

Why is this? In essence, it is not enough for an agency to have statutory authority to enter into real estate lease contracts; it is also necessary for the agency to have sufficient budgetary authority to cover the rental costs over the multiyear contract term (or specific statutory authority to do otherwise). This is true for all agencies, with the exception of GSA (and the other exceptions noted) whether or not the lease is classified as an operating or a capital lease. So, many agencies that possess the authority to enter into real property leases through enabling legislation have come to realize that they cannot avail themselves of that authority, even if the lease is designated an operating lease, because they do not have sufficient budgetary resources to cover the firm-, multi-year lease contract cost.

Many people who are familiar with the federal real estate practice area are likely acquainted with lease budgetary scoring, and know that it is critical that the present value of the minimum rental costs over the lease term not exceed 90% of the asset value at lease inception in order to qualify for an operating lease rather than a capital lease designation (among other budget scoring tests). But the distinction between a capital lease and an operating lease is inconsequential for obligational accounting purposes, unless the agency doing the leasing is GSA. The policy guidance promulgated by the Office of Management and Budget (OMB), contained in Appendix B to OMB Circular A-11, is clear:

"For operating leases, budget authority is required to be obligated up front in the amount necessary to cover the Government's legal obligations, consistent with the requirements of the Anti-Deficiency Act. This will include the estimated total payments expected to arise under the full term of the contract or, if the contract contains a cancellation clause, an amount sufficient to cover the lease payments for the first year plus an amount sufficient to cover the costs associated with cancellation of the contract. For operating leases funded by the General Services Administration's Federal Buildings Fund (which is self-insuring under existing authority), only the amount of budget authority needed to cover the annual lease payment is required to be obligated." (Appendix B, page 2; emphasis added.)

For many years, the Appendix B language held out the prospect that other agencies with self-insuring funds could be accorded treatment similar to GSA, but a check-in with OMB was required in each case. That language disappeared from the Appendix at least two years ago; now GSA alone is accorded the ability to obligate only the first year's rental cost.

What is operative here are the Anti-Deficiency Act (31 USC 1341), and the recording statute (31 USC 1501). The Anti-Deficiency Act (ADA) prohibits federal employees from making or authorizing an expenditure in an amount in excess of what is available in an appropriation, or in advance of an appropriation. The recording statute requires that the amount of a binding agreement (e.g., a written contract) between an agency and another entity be recorded as an obligation of the U.S. Government. These statutory provisions in con-

Do You Know who Owns Your Building?

by Keith Cunningham and Bob Homan,
U.S. Government Accountability Office

Would it matter if an FBI, IRS, or Social Security office was owned by a foreign entity? Would it depend on the country? Should the agencies know? These provocative questions created the context for the House Committee on Oversight and Government Reform to request GAO to determine if foreign entities own the buildings that house high security federal operations and any potential risks. GAO's resulting report, issued in January 2017, found that GSA is leasing space for 26 federal agencies with sensitive missions from companies based in foreign countries—often without the knowledge of GSA or the tenant agencies.

Those agencies occupy about 3.3 million square feet at an annual cost of about $97 million and use the space for a variety of sensitive operations, including storing classified data and law enforcement equipment and evidence. And that is not all—GAO was unable to identify ownership information on one-third of the leases of space that require higher levels of security protection. Table 1 (below) identifies the 20 of the 25 leases for high-security space that GAO identified as foreign-owned. The tenant agencies for the other five leases determined that the information about the foreign companies that own their buildings is too sensitive for public release. That information is included in a second version of the report that is for official use only.

Besides GSA, other agencies use their own statutory authority to lease space from foreign companies. For example, the State Department is leasing space for the U.S. ambassador to the United Nations in the Waldorf-Astoria Hotel in New York City, which was acquired by a Chinese company in 2014. [The original source report GAO-17-195 contains photos of some of the foreign-owned GSA-leased spaces—*Ed.*]

Foreign Investment is Growing

If current trends continue, foreign ownership of federally leased space will increase. According to Real Capital Analytics, annual foreign investment in significant U.S. commercial office buildings more than doubled in four years, from $11.7 billion in 2011 to $26.5 billion in 2015, led by investors from Canada, Germany, China, Norway, and South Korea (see the Figure below). Foreign investment is generally positive for the U.S. economy and is encouraged by the federal government. For example, the SelectUSAInitiative was created in 2011 through executive order to encourage foreign investment in the United States and recent legislation, if passed, would create tax benefits for foreign investment in the United States. In addition, federal buildings are viewed as safe investments that produce reliable returns

Potential Security and Money Laundering Risks

Despite the benefits of foreign investment in the United States, insider threats—which can include the owners or people they employ—represent a significant threat to the cybersecurity of buildings. Federal facilities contain building and access control systems—computers that monitor and control building operations such as heating and air conditioning systems—that are increasingly being connected to other information systems and the Internet. The increasing connectivity of these systems heightens their vulnerability to cyber attacks, which could compromise security; damage temperature-sensitive equipment, such as in data centers; and provide access to information systems. Federal officials who assess foreign investments in the United States and some tenant agencies told GAO that leasing space in foreign-owned buildings could present security risks such as espionage and unauthorized cyber and physical access. For example:

- The Secret Service indicated that its counterintelligence branch determined that foreign ownership of a building it occupies could raise counterintelligence and security concerns. According to the Secret Service, the protection of its information, technology, personnel and space could be in jeopardy if the space were compromised through any unannounced inspections, emergency repairs to the building or any component within, the use of foreign nationals to provide any type of service, and any unescorted access throughout the space by the facility owner or

Letter to the Editor

Dear Editor,
Re: The Old Post Office Deal—A Banner to Good Government

I was in Washington for a week or so last September and headed downtown from my home in Reston for a meeting. That completed, I was on my way to a lunch at a restaurant in Penn Quarter. There I would break bread with some former GSA real estate colleagues. It has been over twenty years since I was the manager of a real estate development program for GSA. My lunch mates would be the guys I worked with back then. Usually about eight or so guys show up for these lunches and I was looking forward to the get-together.

Then I saw it. The Trump Hotel, neé the Old Post Office, on Pennsylvania Ave and draped across the building was a huge “Trump” banner. From my days at GSA I remember the Old Post Office as the redevelopment deal the government never got quite right. It was like Union Station; remember the National Visitors Center? With the Old Post Office it seemed like the government tried everything but nothing worked. Now it would soon be a five-star hotel and according to the new developer, Donald Trump, it would be completed ahead of schedule and under budget.

I was looking forward to seeing my old cronies. But these were all former government guys and I knew the conversation would inevitably turn to the “toxic” nature of the ongoing campaign. There would be lots of references to the latest “outrageous” statements and tweets. I could expect the “have you ever seen such a negative campaign” kind of rhetorical questions. It would be more of the depressing, cynical conversation going on then around the country and infesting the media.

When the lunch conversation made the turn toward the election that banner came back to mind. I told my buddies that there on America’s Main Street was the banner of a New York real estate developer who was also campaigning to succeed President Obama. The night before I saw candidate Trump on TV questioning the very competence of the incumbent. Mr. Trump never seemed to pass up an opportunity to criticize the President often in the most vituperative terms. The man Trump attacked so vigorously was not only his political opponent but also the CEO of the organization that owned the property that Trump and his family had invested vast resources in redeveloping. Donald Trump decided to run for President after he had been awarded the Old Post Office deal. Neither Trump nor anyone else ever seemed to consider the possibility of losing the deal as a result of his political ambitions or actions.

With all the negative stuff that went on during our recent election season it is important to reflect on the power and sustainability of our national values and of our governmental systems. There are many places in this world where a candidate like Trump saying the things he said about a powerful political leader would lose not only the deal but his life. In our country there was this monster banner that announced the coming of a new hotel. But more importantly to citizens that banner was a bold witness not just to a successful real estate deal but the endurance, objectivity and yes, purity, of our electoral system.

As I think back on that lunch I would tell my friends that we now will inevitably be embroiled in debates over the conflicts of interest and the ethical issues surrounding our new President and the Old Post Office deal. We can expect the endless opining of law professors and ethics counsels from earlier administrations on “avoiding even the appearance of a conflict of interest.” But I would tell them we should not let those discussions diminish the importance of that banner and the pride all Americans can take in what it represented for our system of governance.

Our Founders probably did not anticipate the advent of career politicians. They certainly did not expect politicians to grown rich in elected office. They thought citizens successful in other walks of life would offer their experience and skills in public service. In a nation grown cynical about the motives of its politicians and compulsive about avoiding the appearance of a conflict of interest let’s look at the Old Post Office deal as the inevitable challenge we must confront when successful people offer themselves in service to the country. We will figure it out.
—Patrick J. Keogh

Pat Keogh is a contributing editor to the Journal—*Ed*.

Congressional Corner: Status of Recent Legislation

PL 114-287: Federal Asset Sales and Transfer Act of 2016

In brief, FASTA would establish a commission to identify excess properties for sale, with the proceeds reinvested to fuel additional sales over a six-year period aimed at helping the federal government shed substantial millions of dollars in excess property. The effort picks up on previous bills like the Civilian Property Realignment Acts of 2011 and 2013, and the Federal Real Property Asset Management Reform Act of 2013, which all failed.

This latest bill also aims to decrease the deficit by consolidating and selling excess Federal tangible property and would establish an independent board to be known as the Federal Tangible Property Management Reform Board. The Board would consist of seven members whose terms would be for six years. Of particular interest, the Board would have to assemble a database of all Federal civilian real property owned, leased or controlled by agencies, including age and condition of the property; operating costs; history of capital expenditures; sustainability metrics; number of Federal employees and functions housed in the respective property; and the square footage of each property; and would indicate properties reported as excess and declared surplus which no longer met the needs of the agency.

The Board would have to identify not less than 5 Federal civilian real properties that were not surplus or excess having a total fair market value of not less than $500,000,000; and each agency would have to submit a report of excess properties which within 120 days after that, initiate the sale of those excess properties at fair market value at highest and best use.

From the perspective of the Industry, not later than one year after the date of the enactment of this Act, GSA is to publish a single, comprehensive, and descriptive database of all Federal tangible property under the custody and control of all Federal agencies (other than national security properties) and make the database publicly accessible at no cost through GSA's Web site.

Net proceeds are to be deposited into the appropriate tangible property account of the custodial agency; the net proceeds resulting from such sales can be expended as authorized in annual appropriations Acts, with any unexpended used for deficit reduction.

PL 114-318: Federal Property Management Reform Act of 2016

This Act, sponsored by Rep. Jeff Denham (R-CA) and Rep. Jason Caffetz (R-UT), would increase the efficiency and effectiveness of the Federal Government in managing property of the Federal Government on the part of the United States Postal Service, and establish a Federal Real Property Council to develop guidance on and ensure the implementation of strategies for better managing Federal property. Including development of utilization rates consistent throughout each category of space, considering the diverse nature of the Federal portfolio and consistent with nongovernmental space use rates; develop a strategy to reduce the reliance of Federal agencies on leased space for long-term needs if ownership would be less costly; provide guidance on eliminating inefficiencies in the Federal leasing process; and develop a list of all leases (other than Postal Service and national security properties).

<u>Update</u>: These Acts were signed into law by then President Barack Obama on December 16, 2016. FASTA is waiting on the appointment of its Commissioner by President Trump and the six Assistant Commissioners by the House and Senate, as well as on the appropriation by Congress of its operating budget of $42 million. OMB will have general oversight of FASTA and GSA is preparing a data call in accordance with the Act for all land holding agencies; GSA is also to design a template for use with the Commission's recommendations for the disposal of underutilized surplus property.

The Commercial Building Tax Deduction and How it Affects Owners of Commercial Real Estate

by Jeffrey Kirks, Kirks Education and Leroy Battle, Urban Ventures

Among owners and managers of commercial real estate, there is an ongoing quest for new practices to reduce operating cost and increase revenues. The debate over the efficacy of green building technology has long been resolved as client and market demands have impacted this space. While not widely used, the Energy Policy Act of 2005 (P.L. 109-58) authorized the Energy-Efficient Commercial Buildings Tax Deduction for expenses incurred for qualified energy efficient building investments made by a building owner. In government-owned buildings, the deduction may be allocated to the firm or persons primarily responsible for designing the qualified improvements. The deduction may be taken in the year the energy-efficient improvements are placed in service. The "Consolidated Appropriations Act, 2016" extended this deduction through December 31, 2016. The provisions authorizing the deduction are codified in the 26 U.S.C. § 179D.

The Energy-Efficient Commercial Buildings Tax Deduction (CBTD) is a significant financial incentive for building owners and designers to meet or exceed an agency's energy reduction requirements for new and existing buildings. Through three case studies we will examine the viability of the deduction, pitfalls, and benefits and conclude with recommendations to make the deduction more effective.

The 179d Tax Deduction, Section 1331 of the Energy Policy Act of 2005, enacted Section 179d of the Internal Revenue Code which provides federal tax deductions worth up to $1.80 per square foot for commercial buildings that have been newly constructed or retrofitted since December 31, 2005, thru December 31, 2016. The CBTD has been consistently extended every year and may likely be extended again, but for now, it is scheduled to sunset at the end of 2016.

Building owners are eligible for substantial tax deductions for energy efficient buildings or renovation projects. The deduction that is allowed by the IRS is the EPACT 179D Energy Tax Deduction. Section 179D allows a tax deduction to building owners and designers who have designed, constructed or renovated building to meet current energy efficiency standards.

Buildings constructed to 2006 or later energy codes, or buildings that are LEED Certified, will likely qualify if the ownership of the buildings pay corporate income tax. If the building is owned as a Limited Liability Corporation (LLC) then the partners of the LLC may use their deduction if eligible, through their K-1 filing. As a result, many REIT owned assets would not qualify for this deduction.

Three building systems: HVAC, Lighting and Building Envelope each qualify for up to $0.60 per square foot to total $1.80 per square foot should the building qualify for the maximum deduction in each category. The deduction is available to commercial building owners and tenants who may have invested in the improvements, as well as the designers of Government buildings. The Emergency Economic Stabilization Act of 2008 extended the Energy Efficient Commercial Buildings Deduction through December 31, 2016.

The basis for developing and supporting this deduction is a detailed engineering analysis, as prescribed by the IRS that was conducted by the Kirks Institute in conjunction with Urban Ventures. The process for obtaining the179D deduction requires a detailed analysis that utilizes energy modeling software that has been approved by the government and must be certified by a qualified third party. The case studies provided below further illustrate the process and qualifying deductions.

Pursuant to the requirements of IRS Tax Code 179D, these savings have been calculated using the protocols outlined in ASHRAE 90.1-2004 Appendix G and the code minimum performance values published in ASHRAE 90.1-2001. In addition to these standards, the modeling protocols for each case have been performed in accordance with the document ***"Energy Savings Modeling and Inspection Guidelines for Commercial Building Federal Tax Deductions"*** published by NREL (see http://www.nrel.gov/docs/fy07osti/40467.pdf).

Litigation and Dispute Resolution

by Contributing Editor Tom Rochford

1441 L ASSOCIATES, LLC, v. GENERAL SERVICES ADMINISTRATION, CBCA 3860, March 6, 2017

At issue in this dispute is the interpretation of a Lease Extension Agreement as it relates to the cumulative operating costs to be paid by the GSA. The Lessor contends that it is entitled to cumulative operating costs beginning in year one of the extension, calculated from the start of the twenty-year lease, with index adjustments for the final two years of the extension period. The GSA contends that for the first year of the extension period the lessor is entitled to operating costs adjustments calculated utilizing an operating costs ten years into the underlying lease, and index adjustments calculated utilizing that figure for the final two years of the extension period. The agency contends that a portion of the operating costs are included in the $616,248.50 monthly figure, such that any additional payment would represent duplicative recovery of operating costs by the lessor.

The extension agreement specifies that the annual rent for the extension term shall be payable at a rate of $616,248.50 per month plus accrued operating costs. Further, the rent shall continue to be adjusted for operating costs escalations. The agreement both recognizes that the current annual escalated operating cost amount was $1,696,355.10 and that the agency shall continue to pay to the lessor the cumulative operating expense adjustments over the original base year. The plain language of the written agreement dictates the result.

In addition to the basic rent, the lessor is to receive accrued operating costs, also referred to as cumulative operating expense adjustments. No adjustment would be made for year one; however, indexed adjustments would be made for years two and three. The monthly adjustments over the original base year were $52,470.97. The phrase “original base year” does not mean a figure utilized at the ten-year period of the lease.

The agency requests that the Board consider parole evidence to support its interpretation. It is permissible to consider parole evidence if such supports the plain language of an agreement. Here the parole evidence indicates that the lessor did not agree to agency attempts to alter the original base year of operating costs as the starting point for payments to supplement the basic rent. The formulation of an agreement with operating costs included in the basic rent was considered, but was not adopted. The contracting officer did not establish an interpretation that was consistent with the negotiations to reflect a mutual intent.

Finally, the agency suggests that the lessor would receive a windfall if its interpretation is adopted. The bilateral written agreement provides for payments during the extension period. The agency is obligated to pay in accordance with the agreement. However, the agency also has not demonstrated that the lessor’s interpretation would result in a windfall or duplicative payments. While the agency and this contracting officer harken back to SLA 50 as resetting the operating costs base, in fact, that SLA noted the basic rent and the adjustments of the accumulated operating costs, which for ease of calculations resulted in a single number for calculations from that point forward; however, the agency was obligated to pay the accumulated operating costs adjusted from the start of the lease. Nothing changed through SLA 81. The lease extension did not alter this agency obligation to pay cumulative operating costs.

Payment

The lessor seeks $249,356.63 annually, for the entire extension period, plus accrued interest. This roughly represents the originally sought $52,470.92 per month as the cumulative operating costs less the amount the agency concedes it is obligated to pay $31,691.24 per month.

The plain language of the lease supports the entitlement sought by the lessor. However, the lessor already received payment of a portion of the $249,356.63 for some months during year one of the extension such that a reduction must be made. Further, a reduction to operating costs payments may be required for years two and three after the space reduction during year two.