

Pros and Cons of Leasing to the Government

A large, blue sign with the words "FOR LEASE" in white, bold, sans-serif capital letters is positioned in the bottom right corner of the page. The sign is partially cut off on the right side. The background of the page is a photograph of a multi-story building under construction, showing wooden formwork and scaffolding against a blue sky with light clouds.

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Pros and Cons of Leasing to the Government

The General Services Agency's Public Buildings Service provides workspace for more than 1.2 million federal employees representing over 400 federal agencies. About half of those workers are housed in federally-owned properties while the other half work in the approximately 8,100 properties that are currently leased to the federal government by private owners. Of those 8,100 offices, laboratories, warehouses and clinics leased to the government, about half encompass less than 10,000 square feet, which means that a variety of commercial real estate owners with portfolios of all sizes have the potential to lease their property to the federal government.

Why the Government Leases Property

When a government agency needs to obtain workspace for its employees, the agency may not have sufficient funds appropriated within its annual budget to purchase a facility. On the other hand, an agency that chooses to lease will have predictable monthly expenses that fall within their budgetary constraints. Instead of constructing or renovating buildings, agencies can acquire turnkey facilities that are ready to operate. Additionally, agencies will not have to deal with the costs of aging facilities or renovations when they choose to lease instead of to construct.

Advantages of Leasing to the Government

Few property owners will find a more creditworthy tenant than the federal government. Federal government tenants are obligated to pay in a timely manner, and most tenants stay in place for a number of years. Often, government agencies choose to expand further into the current space or into nearby properties that may be owned by the same landlord. Additionally, government tenants attract many kinds of businesses that are both in need of office space and willing to pay a healthy rent for proximity to a government tenant.

Another advantage of leasing to the government is predictability. While the first experience of leasing may seem overwhelming because of all of the bureaucratic and procedural requirements, property owners who repeatedly lease to the government will find that the process is quite consistent. Therefore, after the initial trial, building owners may find that they like the consistent procedures and predictability associated with doing business with the GSA.

Additionally, leasing to the government provides stability to a commercial real estate portfolio. In uncertain economic times when commercial leases are dependent on the health of a business, landlords can rest assured that the federal government will not run out of funds.

Even though a property owner may find a government opportunity less lucrative and more onerous, the process also carries less risk as long as the landlord can fulfill the requirements of the contract.

Potential Challenges Associated with Government Leases

Leasing real estate to the federal government has potential pitfalls that property owners must understand before starting the bidding process.

- *Building owners must use government leasing documents.* The GSA has its own standard leasing documents that the property owner is required to use in place of his or her usual lease. These leases are often over 100 pages long, and building owners must review all of the contents so that they understand the provisions and any potential associated issues.
- *No changes are permitted to government leases once they have been negotiated.* After a property owner has submitted a "Best and Final Offer" to the government, no changes in the lease are allowed. When the government accepts an offer, then the offer becomes binding in the strictest sense. The building owner must enter into the lease even if a more lucrative commercial opportunity presents itself. Because of the strict nature of the contract, building owners must carefully review all contents of the lease well before they receive a Notice of Award.
- *Government leases contain many additional requirements that exceed those found in commercial leases.* Before leasing, a commercial property owner must understand the exact definition of terms and conditions from a government perspective because many of the definitions will differ from those used in the private sector. The government will have the sovereign right to make certain unilateral changes to the lease, and property owners will often be subject to certain government labor and sub-contracting requirements. Additionally, building owners may have to make improvements to meet government standards for security, safety and accessibility. Before making an offer, building owners must consider the costs associated with any improvements that will be required.
- *Statements or claims made to the government could be subject to civil and criminal penalties.* Property owners must be careful about any representations that they make to an agency, particularly if they involve payment line items. Any allegations of false statements or claims could have serious consequences.
- *Owners who fail to follow government procedures could experience serious financial repercussions.* Any failure to comply with government procedures could result in non-payment from the agency. Leases can be terminated for default, or agencies may perform work on their own

and then charge the property owner for the work. Any government complaints about performance problems could result in difficulty with winning future GSA leases.

- *The government has to give its consent before a lease can be assigned to a new building owner.* If a property owner decides to sell while housing a government tenant, then the government is not required to continue the lease after the sale. Also, even if the government does agree to continue the lease, the new owner has to assume all of the responsibilities and liabilities of the former property owner. This means that buyers may be less inclined to purchase a building that is currently under a government lease, which will give the property owner less liquidity. *Not all government agencies use space in the same manner.* A Social Security Administration office will see much more public traffic than a quieter office, such as an office for the Securities and Exchange Commission. Therefore, property owners have to consider the potential risks to the facilities from public access before considering bidding for a lease.

Many inexperienced buyers decide to purchase foreclosed properties or REOs with government leases. These buyers then find themselves unprepared to deal with the associated complexities and compliance requirements of a GSA lease. Before purchasing a distressed property, buyers must perform due diligence to find out whether a government agency has a lease within the property.

Additionally, new owners should know that until they sign a novation agreement assuming all of the responsibilities and liabilities of the previous owner, the government may choose to place rent payments in escrow. One particularly important item to property owners is ensuring the accuracy of invoicing. Invoices should be both accurate and timely to avoid non-compliance with lease administration activities.

How to Compete for Government Leases

When a government entity needs space, the agency releases a Solicitation for Offers, or an SFO. The SFO explains the type of facility needed, the quantity of space needed and any terms or conditions of the lease. Each SFO also explains how to submit a proposal, provides the address and contact name for the proposal and gives the deadline by which proposals must be received.

When an agency requires 10,000 or more square feet of space, that agency will advertise in a local newspaper or through the Federal Business Opportunities website. For requirements of 10,000 or fewer square feet of space, the agency usually informally canvasses spaces or makes contact with potential offerers. If a landlord of a smaller space wishes to be considered for a government leasing opportunity, then he or she should contact the appropriate regional office.

After receiving proposals, the GSA will negotiate with offerers and award contracts to the landlord making the lowest-priced acceptable offer. For larger spaces exceeding 10,000 square feet, the offer includes a building rate and a specific allowance for the build-out of tenant space. When the GSA makes its final decision, the final build-out total is negotiated based on design drawings of the offered space. When negotiations are complete, the GSA begins monthly payments for the lease in arrears.

Conclusion

Real estate professionals who specialize in commercial property should ensure that they are aware of the complexities associated with properties, particularly distressed properties that have been leased to the federal government.

Also, realtors who want to represent buyers and sellers in this niche should maintain a strong network of legal representatives and construction professionals who have experience with fulfilling the requirements of a government contract. For instance, realtors will bring added value to their clients by being able to recommend sub-contractors that meet some of the government's socioeconomic requirements for sub-contracting to small businesses or to minority-owned businesses.

As the federal government looks for ways to trim its budget, more and more agencies may choose to allow private sector business owners to compete for government leases. Realtors who gain expertise concerning federal government leases will possess specialized knowledge that will appeal to many potential clients.

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