Federal Perspective
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Trump administration set to reshape the federal office landscape

Changing priorities within a Republican-aligned government will likely spur a period of robust political action on Capitol Hill.

Although a potential repeal of sequestration may provide a boost to the defense sector, other discretionary spending programs may be impacted by the new administration’s focus on privatization and deregulation.

Regardless of the new administration’s ability to enact change, a degree of uncertainty is likely to persist over the federal office market, as policies remain in place to reduce the size of the government’s footprint and trim the federal workforce

Select agency forecast

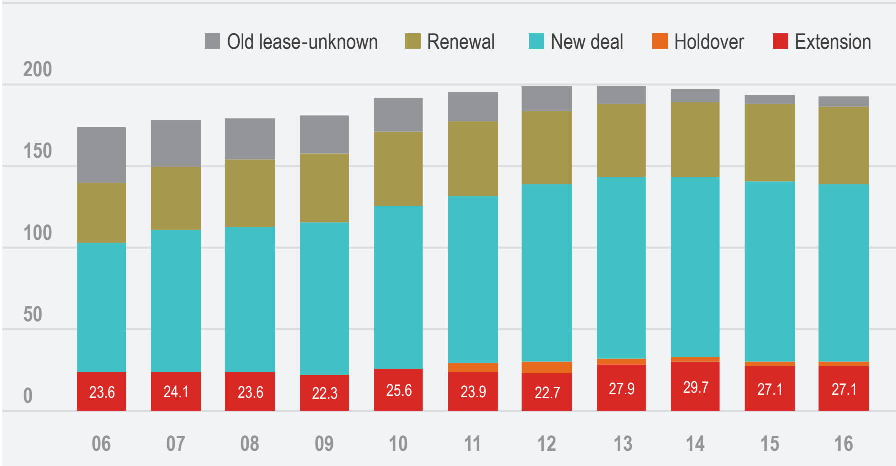
Customs and Border Protection
Immigration and Customs Enforcement
Department of Defense
Department of Veterans Affairs

National Institutes of Health
Department of Transportation
Federal Bureau of Investigation
Central Intelligence Agency

Department of State
Department of the Interior
National Science Foundation
Department of Energy
Department of Education
National Labor Relations Board
Environmental Protection Agency
National Endowment for the Arts

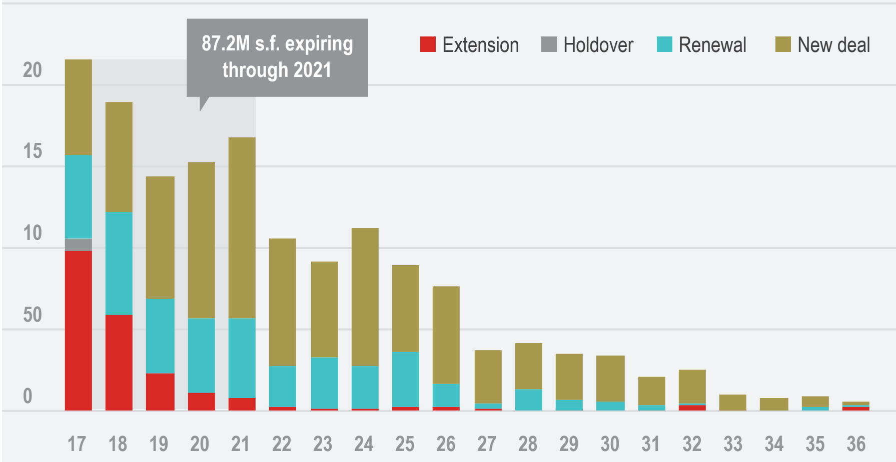
GSA-leased space across the U.S. has declined since 2013; holdovers have reduced, while extensions have grown 14.8% since 2006

250 s.f. in millions (Holdover data only available back to 2011)



GSA U.S. lease expiration pipeline

25 GSA lease expirations (s.f. in millions)



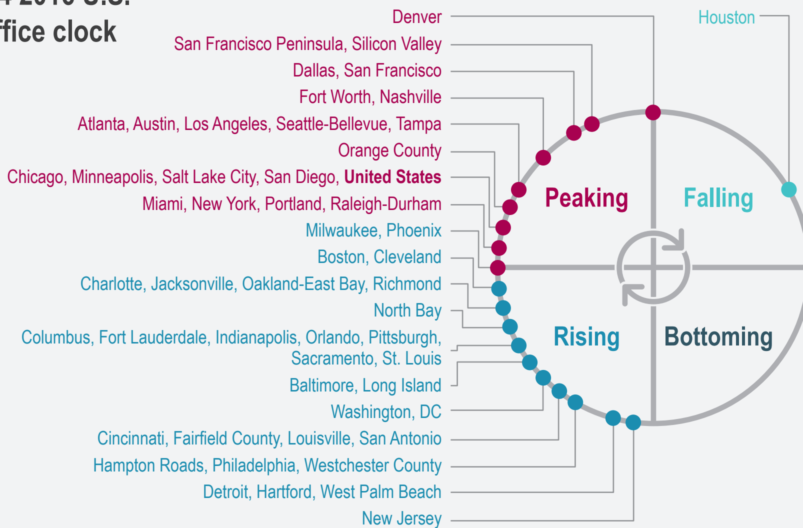
Throughout the campaign season, President Donald Trump outlined strong policy positions on several key issues, including immigration reform, rebuilding the military, repealing and replacing Obamacare and reinvesting in the nation's infrastructure. Although these hallmark positions may fuel segmented growth within some agencies that assume a new or expanded mission, the introduction of a 90-day federal hiring freeze and sharp rhetoric surrounding "draining the swamp" will likely reduce the size of the federal workforce and accelerate the decline in government-leased office inventory.

Based on the initial policy positions outlined by President Trump for his first 100 days in office, it is reasonable to assume that some federal programs will be on the chopping block as the administration's push for privatization and deregulation impact agencies such as the Department of Energy, Department of Education and Environmental Protection Agency, among others. The groundwork for much of the administration's plans are summarized within President Trump's "Contract with the American Voter," which broadly seeks to reduce the size of government and improve federal agencies' operational efficiency. While the plan outlines a hiring freeze for federal employees, the expanded mandate for groups such as Customs and Border Protection and the Department of Defense should create a dynamic of winners and losers, in which favored agencies grow headcount and real estate demand, while others enter a period of contraction.

While the Reduce the Footprint policy is likely to remain in effect throughout the federal government, changing power dynamics in Washington will likely create new opportunities within the real estate market. Change has a tendency to create both challenges and opportunities. The gridlocked government of the past six years resulted in more short-term leasing and a gradual reduction in federally leased inventory – trends that were largely value-destructive to real estate owners and developers. Although a gradual reduction of the federal footprint will likely continue under the new administration – and perhaps accelerate within certain agencies that face the most acute budget cuts – the President's background in real estate and experience as a dealmaker will likely create a swift period of action as major projects such as the FBI headquarters exchange; Citizenship and Immigration Services campus build-to-suit; redevelopment of St. Elizabeth's; Federal Triangle South project and various other federal building acquisitions and dispositions are closely evaluated and provided decisive guidance.

There is a well-established precedent for single-party alignment serving as a catalyst for action on Capitol Hill, in which partisan gridlock is eased, more debate comes to the floor, more legislation is enacted and greater direction is provided for agency budgets. If historical correlations hold true within the National Capital Region, this is likely to spur greater leasing velocity, increased occupancy growth (at least within the private sector) and longer-term lease transactions. These potential outcomes should be accretive to real estate investors and a welcomed change given the past six years of government gridlock, shortened lease terms and general stagnancy throughout the federally leased office market.

Q4 2016 U.S. office clock



Recently completed leases continue to emphasize space efficiency

Former aggregate size

New aggregate size

Completed prospectus-level deals issued 2012–2016 called for a net reduction of 10.7%

Holdovers on the decline → Diminishing rate of rightsizing → Return of long-term leases → **Value creation on the horizon**

In recent years, executive orders focused on reducing the size of the federal footprint sent shockwaves throughout the office market. Mandates requiring offsets of new leased square footage with consolidations or dispositions and stipulations for decreased space per employee have rendered the days of consistent 1.5% to 3.5% annual growth of federally leased inventory over. Today, government appropriators stringently review large space requirements, forcing agencies to make quantifiable reductions in leased space.

Over recent years, federal consolidations have exerted a quantifiable impact over the GSA leased market. Since peaking in 2013, federally leased office space across the U.S. has declined by 3.6%. In Metro DC, the impact has been more acute, as the federal footprint has fallen by 9.3% overall. Short-term activity has surged, with extensions (deal terms of 3 years or less) rising by 48%. The historically high likelihood of renewals has been disrupted.

GSA is now several years into its rightsizing process and, in the words of a prominent GSA representative, “the low-hanging fruit has already been harvested,” in terms of consolidation and contraction opportunities. In the time period stretching from 2011 to 2014, GSA space reductions averaged 15% to 25%, with some transactions involving rightsizings of up to 48.7%. Recently completed prospectus-level deals averaged just 10.7% space reductions. The government’s rightsizing process is not yet complete, but it should provide diminishing rates of return in space compression in the years ahead.

With a wave of lease expirations piling up (nearly half of the government’s leased portfolio will expire over the next five years), the market for government-leased space faces a fork in the road. A status-quo scenario of continued consolidation activity may yield a favorable result for investors, as short-term leases are replaced with 10-15 year leases as part of broader agency consolidations, many of which have been planned over the past 3-5 years. Although aggressive lease rates may have affected underlying asset values, these long-term leases will make the properties more attractive for refinancing or disposition.

Despite the recent upheaval in federal leasing dynamics and radical departure from historical decision-making tendencies within GSA, government-leased real estate remains an attractive long-term investment and should be a critical component of any diversified commercial real estate portfolio. The U.S. economy is currently seven years into an expansionary cycle and the historical average duration of economic cycles is typically six to eight years. A downturn in the broader economy is likely to subject privately leased real estate portfolios to substantial credit risk as tenants lacking the same financial stability as the U.S. federal government disrupt net operating income. Government-leased space therefore is an attractive hedge in this type of market cycle.

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