Statement of

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On Behalf of the
Building Owners and Managers Association (BOMA)
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Association (AOBA) of Metropolitan Washington, DC

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Development, Public Buildings and Emergency Management
Committee on Transportation and Infrastructure
United States House of Representatives

The Serious Commercial Real Estate Credit Crunch and GSA:
Leasing and Building During an Economic Crisis

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Good morning, Chairman Norton, Ranking Member Diaz-Balart, and members of the Subcommittee. Thank you for holding this important hearing on the Serious Commercial Real Estate Credit Crunch and GSA: Leasing and Building During an Economic Crisis. I am Dick Purtell, Portfolio Manager of Grubb and Ellis Management Services, Inc, and I am here today in my role as Chair and Chief Elected Officer of the Building Owners and Managers Association (BOMA) International and our local association here in Washington, the Apartment and Office Building Association (AOBA) of Metropolitan Washington, DC. As the District's Congresswoman, you may be interested to know that AOBA's members own or manage three-quarters of the city's private office space, and that one-third of the city's privately owned space is leased by GSA.

When I appeared before you late last summer at a hearing on the credit crunch, it was already clear that our nation was in a downward spiral and the commercial real estate industry was beginning to feel the pinch. Unfortunately, there is no good news. Today, the roughly $6.5 trillion income producing – apartment, hotel, industrial, office, and retail – U.S. property market faces its worst liquidity challenge since the Great Depression. With virtually no liquidity, commercial borrowers face a growing challenge of refinancing maturing debt and the threat of rising foreclosures and delinquencies. Through the end of 2009, an estimated $200 to $500 billion in commercial and multifamily real estate loans will mature from a variety of sources. Over the next few years, these maturities increase to well over $1 trillion. We are faced with the dual challenge of developing strategies to stop the downward spiral and restoring confidence in markets.

While the incremental measures taken to date to address this crisis may have fortified the balance sheets of certain financial institutions, they have failed to address the root cause of the problem. It is imperative to enact measures that will enable financial institutions to effectively restructure their balance sheets, to take toxic assets off banks' books and to start lending again on solidly underwritten transactions. By stabilizing financial institutions and restoring confidence to the credit markets, commerce will once again move forward. But the time to act is now.

We are encouraged by the creation of the Term Asset Backed Loan Facility (TALF) and Public Private Investment Fund (PPIF). If engineered properly, these programs could provide credit markets with the economic confidence they need to reconnect in the wake of a broad dislocation and help restart the stalled economy. It is important for these programs to be effective in their efforts to enhance credit capacity and restore confidence to credit markets.

The cost of not taking immediate action grows higher with each passing day. Real estate directly and indirectly generates economic activity equivalent to nearly 20 percent of the nation's GDP. Nearly 9 million jobs are created from real estate activities which annually generate millions of dollars in federal, regional and local tax revenue. Local governments, especially, depend on this revenue, which amounts to approximately 70 cents of every local budget dollar, to pay for public services such as education, road construction, law enforcement and emergency planning and response.

Beyond these industry-wide credit issues that require a combination of solid policies moving forward, available capital and willingness to lend, and a restoration of confidence in the credit markets, there are some specific areas where the private sector and the public buildings sector could effectively work together for our mutual benefit.

First, we congratulate Congress for allocating funds to the General Services Administration (GSA) to implement energy efficiency retrofits in federal buildings. We would like to suggest that these retrofits not be limited to federally owned buildings, but also be allocated to make needed retrofits of space the government leases from the private sector. The building owner will benefit from capital improvements made to the building, the lessee – the federal government – will benefit from improved high performance space while demonstrating leadership, and taxpayers will benefit from job creation and improving our environment. Since most GSA leases are gross leases (meaning GSA pays a set rent which includes utilities), savings resulting from lower energy costs will not be seen immediately but as leases are renewed, base rents could reasonably be expected to be lower as a result of the investment in efficiency.

The construction sector has been especially hard hit in this recession. Projects supported by the stimulus funds, such as solar roof installation, lighting system upgrades, advanced metering, green roofs, and exterior envelope retrofits will have a significant impact on energy consumption and put people to work. Also, GSA and the Department of Energy's focus on improving the performance of solar installations as well as other cutting-edge technologies will also benefit the private sector by testing and mainstreaming new practices and equipment. BOMA members have already made some impressive accomplishments in the energy efficiency and green arenas, and we look forward to benefitting from the expertise and case studies that will be available as a result of the federal government's leadership. As we build tools to help drive energy efficiency, we must also keep in mind the importance of measurement and verification to properly evaluate the effectiveness of our efforts. Investing in Energy Star, benchmarking, and marketplace research, through government efforts such as the Department of

Energy's Commercial Real Estate Energy Alliance (CREEA), which will officially launch next month, will help identify best practices and case studies to move the existing building stock forward.

We would also like to call attention to a growing problem of the government's overuse of short term lease extensions, standstill agreements or holdover tenancies. With increasing frequency, the US Government is asking its commercial landlords to enter into short term extensions at the end of the lease term, instead of renegotiating the lease or giving notice to vacate the space according to the termination terms of the lease. In a good economy, this practice can have some negative consequences to the building owner, but in our present economy, the results can be disastrous and even impact the building owner's ability to refinance.

It is standard market practice in large leases (more than 100,000 square feet) for tenants to provide several years advance notice of their intention to vacate or renew a lease prior to the lease expiration. Even for smaller leases this timeframe is typically one to two years. Some of our member companies have estimated that currently 60% of government leases enter into these makeshift holdover arrangements upon lease expiration.

This practice happens for a variety of reasons. In some cases, the future space needs have not been addressed by GSA's client agencies, which can be due to budget uncertainty and/or the agency's growing pains. Also, the lengthy process for securing Congressional authorization for GSA's large deals goes through the prospectus process and this can cause delays or get bogged down in bureaucracy.

While the causes that necessitate these leaseback issues may be understandable, the result can be costly for both the federal government and for the landlord. Leasebacks carry a large penalty, typically 50 percent above the rent they were paying before lease expiration. In addition to this higher rent, the government deprives itself of the ability to obtain the best financial terms and a full range of options in the marketplace. The government must maintain this negotiation leverage especially now, in this current financial environment where rates and financing are favorable for long term lease deals for credit worthy tenants.

The practice of short term extensions is also problematic for the landlord. If the building is trying to secure financing, potential lenders will treat the space as vacant in the absence of a lease. A vacant or underutilized building will have a low income stream and therefore impact the credit worthiness of the building, which in turn leads to onerous loan terms. In addition, the landlord cannot market the space to potential clients without knowledge of the tenant's intentions to vacate the space.

The government has always been a valued tenant and customer of the private sector real estate community, as well as a great partner to BOMA and AOBA of

Metropolitan Washington, DC. Due to their credit worthiness and the guarantee of payment, many landlords are willing to make significant accommodations for government lease tenancy. However, in the present economy, the increasing practice of lease holdovers is creating additional distress. We encourage this subcommittee to consider ways it can help streamline GSA's leasing practices and eliminate unnecessary bureaucracy. We fully support full and open competition, but with sufficient time remaining on the lease to eliminate the uncertainty and upheaval to the landlord.

We thank the Subcommittee for holding this important hearing and hope this testimony has provided some insight on the affect the credit crunch has had on the commercial real estate industry. I welcome any questions you may have.

**About AOBA**

The Apartment and Office Building Association of Metropolitan Washington, DC (AOBA) is the leading membership organization representing commercial and multi-family residential real estate in the Washington Metropolitan Area. Its members own and/or manage commercial and multi-family residential properties, as well as provide products and services to the real estate industry. The current combined portfolio of AOBA's membership is over 160 million square feet of office space, and over 200,000 apartment homes in the District of Columbia, Maryland, and Virginia. In 2000, AOBA created a wholly owned subsidiary, the AOBA Alliance, Inc., which facilitates and streamlines low-cost procurement of energy services for multi-family and commercial office buildings throughout the metropolitan area. As the largest customer-based aggregation group in the area, the Alliance has aggregated loads for over 180 companies, with nearly 600mw of peak electrical load.

**About BOMA International**

Founded in 1907, the Building Owners and Managers Association (BOMA) International is an international federation of more than 100 local associations and affiliated organizations. BOMA International's members are building owners, managers, developers, leasing professionals, medical office building managers, corporate facility managers, asset managers, and the providers of the products and services needed to operate commercial properties. Collectively, BOMA members own or manage more than nine billion square feet of office space, which represents more than 80 percent of the prime office space in North America. BOMA International has a long history of involvement in energy and the environment. BOMA's commitment to market transformation earned it the prestigious ENERGY STAR *Partner of the Year* award in 2007, 2008 and 2009. In 2006 BOMA launched the BOMA Energy Efficiency Program (BEEP), an educational initiative that teaches important no- and low-cost building operating strategies for optimizing equipment, people and practices. The BOMA 7-Point Challenge, launched in 2007, challenges commercial real estate companies to decrease energy consumption by 30 percent across portfolios by 2012 as measured against an average building using the ENERGY STAR benchmarking tool.