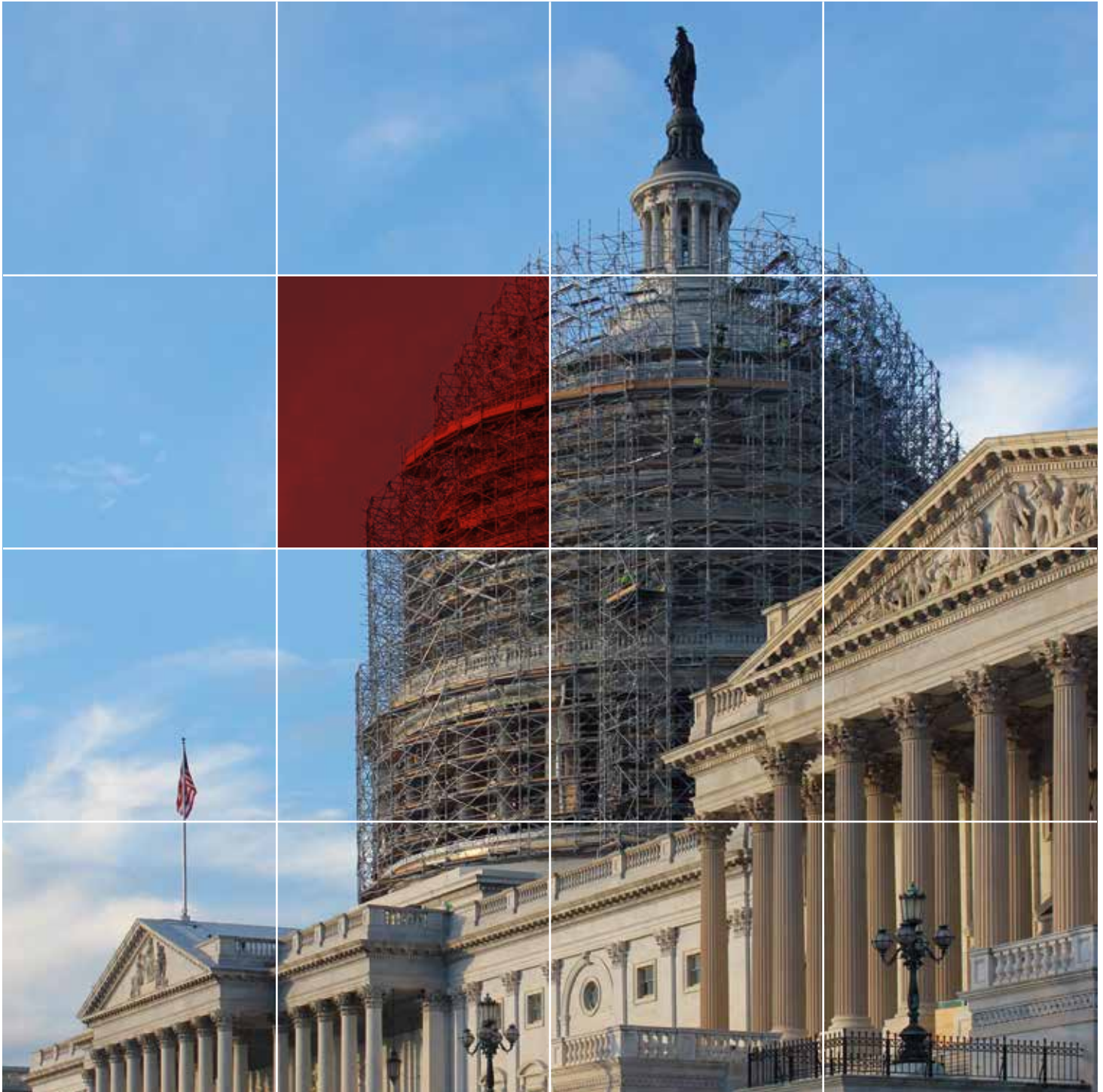




Structural change is coming to the federal leasing market



Welcome to the JLL GIS 2015 Federal Perspective

Under continued pressure to reduce the federal real estate footprint, federal leasing is undergoing a structural change to increase efficiency and cost savings; leasing activity today reflects an inability to make long-term decisions in the face of space reductions, leading to short-term extensions.

The following pages outline our analysis of the current state of federal real estate. The Federal Perspective is divided into three parts: First, an overview of the current budgetary and political environment. Second, a detailed look at the national and regional federal leasing markets. Last, we explore some of the major trends in federal leasing today.

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National overview

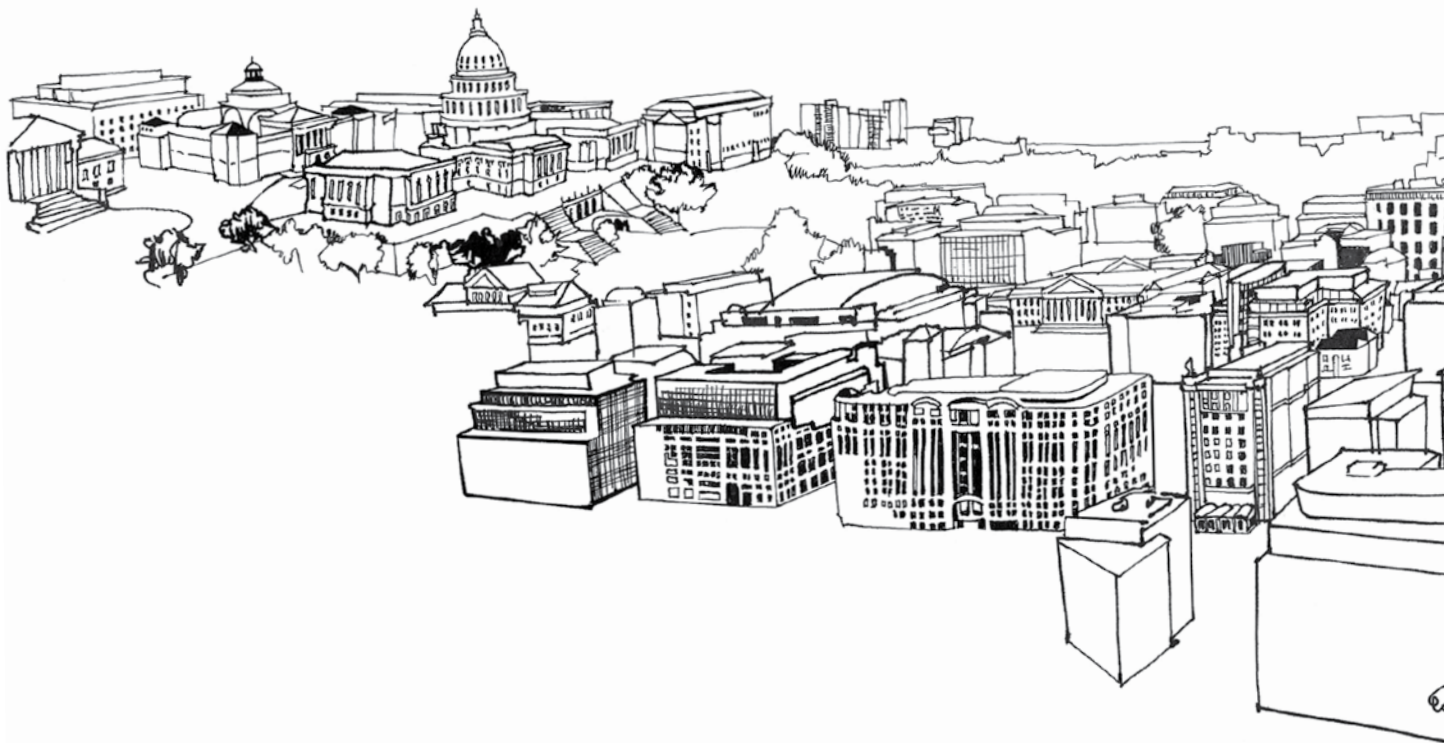
The year in review

As the national economy rebounded throughout 2014, political gridlock persisted in Washington. Federal employment continued to decline, and while the second session of the 113th Congress was poised to benefit from a two-year spending deal, political inaction ahead of the midterm elections resulted in the fewest number of enacted laws recorded in recent history. On account of improving macroeconomic conditions and continued efforts to control government spending, the cumulative annual budget deficit fell to \$506 billion, down from a \$680 billion deficit in the previous year and the lowest deficit since 2008. The total budget deficit for fiscal year 2014 accounted for 2.8 percent of gross domestic product – below the 40-year average of 3.1 percent. Despite a projected decrease in the deficit in the upcoming fiscal year 2015, Congress still focused on reining in the cost of government.

Although spending on leased real estate accounts for less than one percent (0.14 percent) of the overall federal budget, the intense fiscal fight within Congress over larger political issues made reining in federal leasing costs one of the few areas of bipartisan agreement. For several years, the OMB's 'freeze-the-footprint' initiative targeted no new net growth for agencies' real estate footprints. Current leasing practices prioritize efficiency and demonstrating cost savings in new transactions. Recent GSA lease prospectuses generate savings by improving space utilization and opening competition to lower cost markets. Additional cost saving strategies include teleworking and relocating from leased to owned space.

Agencies grappled over approaches to reduce their real estate footprints, delaying leasing activity. The target utilization rates presented challenges by requiring complete reconfiguration of the existing space. As routine leasing activity stalled, most of 2014 focused on high-profile projects such as the new FBI headquarters, DHS consolidation and redevelopment of the Old Post Office; while these projects garnered media attention, GSA utilized short-term extensions to prevent holdovers and buy time to plan larger scale consolidation efforts. Near the end of the fiscal year, GSA utilized these techniques to reduce the number of holdovers within the federal leased portfolio, and at the beginning of fiscal year 2015, the number of leases in holdover dropped 23.6 percent.

The high cost of federal leasing spending came under congressional scrutiny in 2014; the House Committee on Transportation and Infrastructure, Subcommittee on Economic Development, Public Buildings, and Emergency Management held a hearing titled "GSA Tenant Agencies: Challenges and Opportunities in Reducing Costs of Leased Space." The hearing scrutinized wasteful practices under the current trend of short-term extensions as opposed to long-term renewals or new leases. Recent prospectuses – the National Labor Relations Board's (NLRB) move to 1015 Half Street, SE and the National Nuclear Security Administration's (NNSA) move to the Portals project in Southwest – highlight large concession packages for the government on long-term deals. In previous years, the discussion focused on achieving cost savings by moving from leased to owned space. Chairman Lou Barletta tasked seven agencies with committing to long-term lease requirements of at least 10 years. Public Buildings Service Commissioner Norman Dong has also committed to cutting down the backlog



of lease expirations. Signaling that legislators were taking necessary steps to allow agencies to evaluate space needs and make longer-term leasing decisions, the Financial Services and General Government Appropriations Bill for FY2015 included \$100.0 million for consolidation activities.

As mid-term elections approached at the end of fiscal year 2014, legislators quietly passed a continuing resolution, providing funding for the federal government until December 11, 2014. The bill sets discretionary funding at an annual rate of \$1.012 trillion, but also addresses current national security issues, including ISIL, Ebola and Ukraine. While the budget avoided another government shutdown and addressed current affairs, agencies are once again left without a policy roadmap.

Looking forward

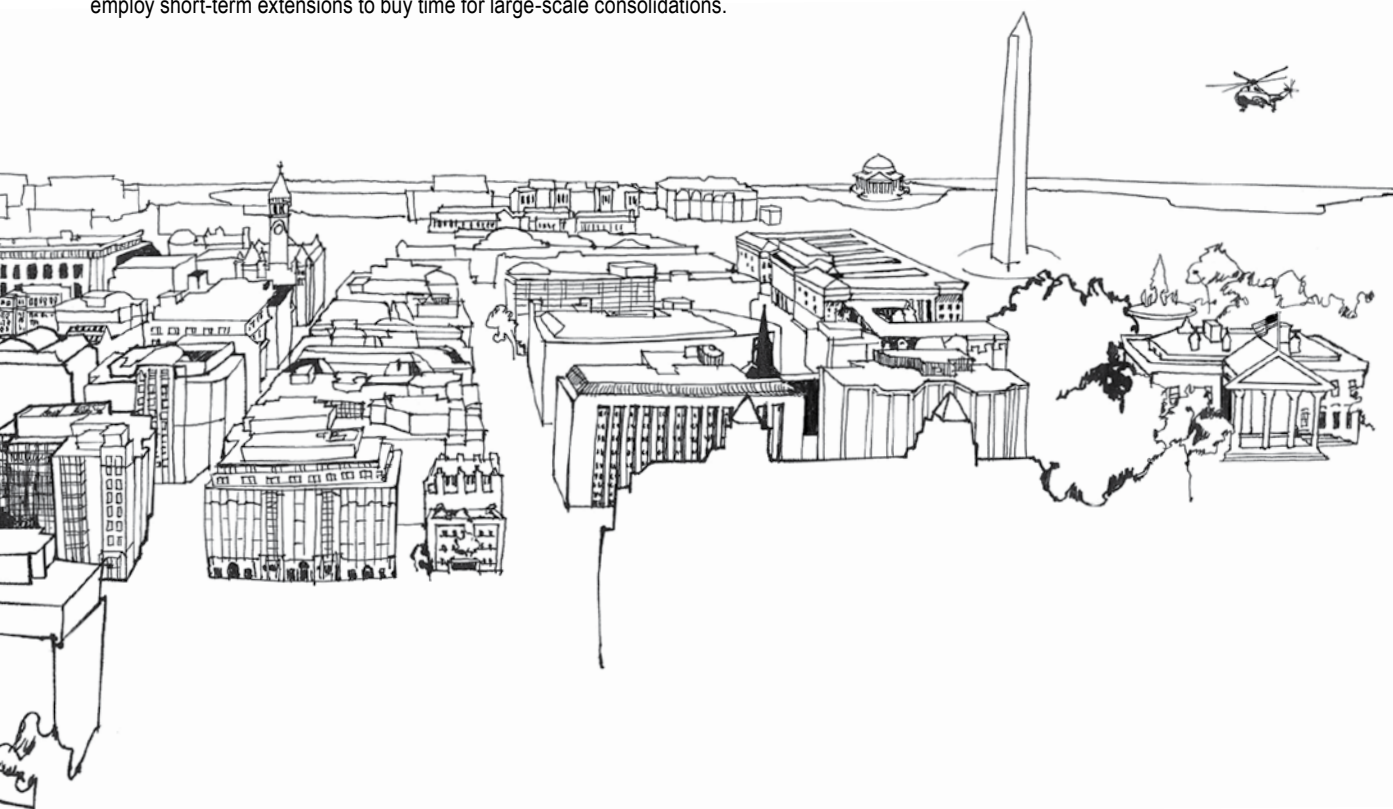
The 2014 elections saw the House and Senate fall into political alignment, creating the potential to establish a unified and decisive strategy in the years ahead. As a result, federal agencies will find the clarity necessary to make long-term space decisions. Leasing activity should increase throughout 2015, however, as the federal government enters a new leasing paradigm, the rate of growth of the real estate portfolio is expected to remain flat or trend downward.

Agencies remain tasked with finding long-term solutions to space needs without a means to do so. As a result, some are expected to continue to employ short-term extensions to buy time for large-scale consolidations.

Others may choose to delay leasing decisions as a means to wait out space utilization scrutiny and reductions. Recent GSA deals lack the length of term traditionally expected from the federal government; the resulting build-up of short-term leasing activity, combined with rollover from 9/11 leasing activity, indicates accumulating demand and suggests more action will occur in 2015.

In 2014, an estimated 29.0 percent of the federal workforce opted to telework, up from 19.0 percent in 2011. Recently, a study of teleworking practices at the Patent and Trademark Office questioned the productivity of the award-winning program. Increased scrutiny of the effectiveness of teleworking could stabilize demand for office space as the government evaluates productivity consequences.

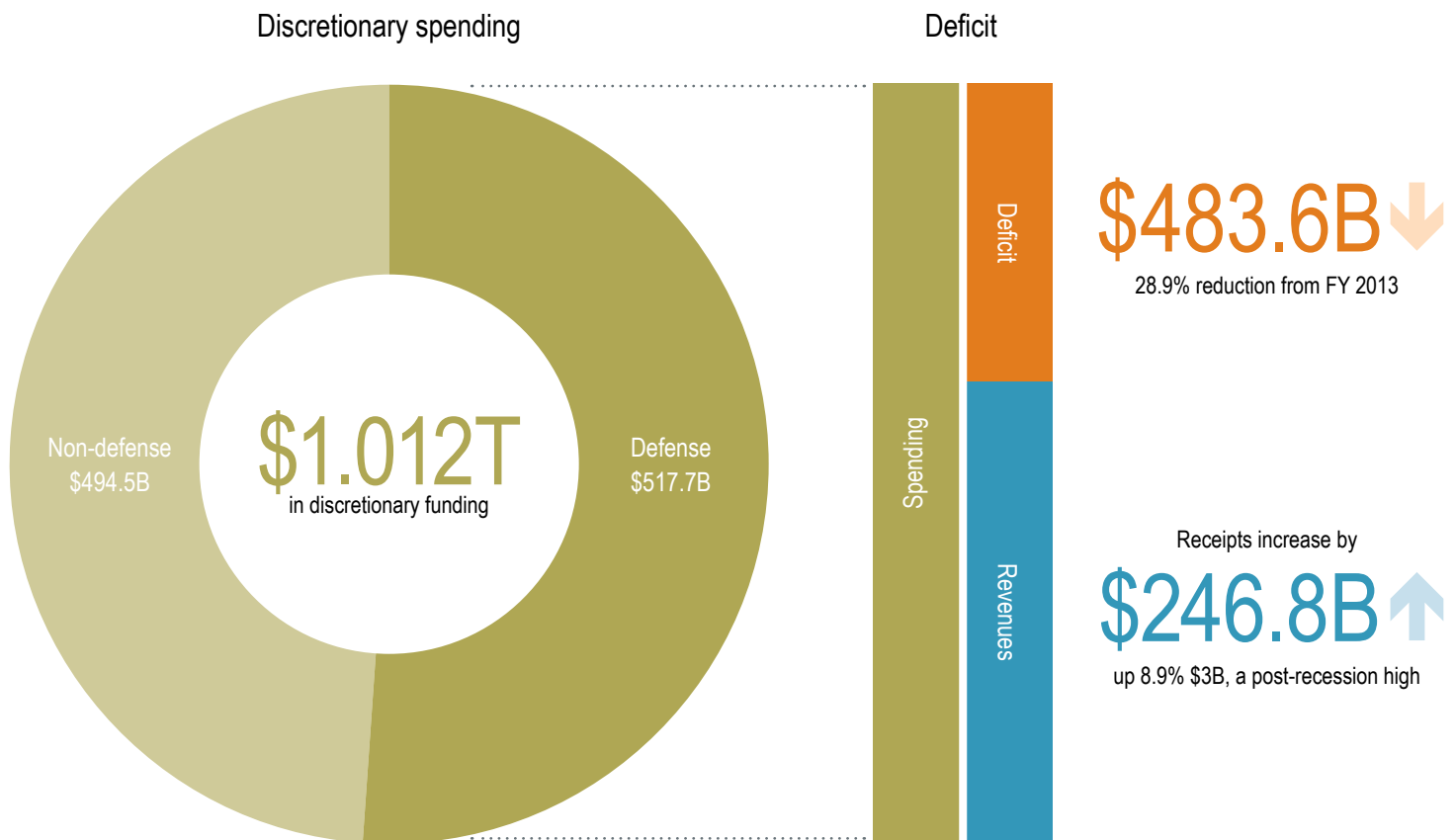
GSA's historically-high lease rollover, coupled with increased scrutiny for short-term leasing activity, should result in longer-term transactions coming down the pipeline. As the federal government enters a new leasing paradigm, the focus on cost savings and efficiency could lead to increased relocations as incumbent buildings face additional hurdles, such as finding swing space, while the existing tenant space is reconfigured. Recently, six federal agencies announced plans for new target utilization rates; the new average across these agencies was 147 square feet per person.



Federal spending overview

Why do you care?

The federal budget provides the road map for future spending; improving deficits could lead to less scrutiny for government spending

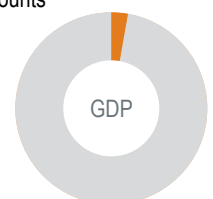


Revenues

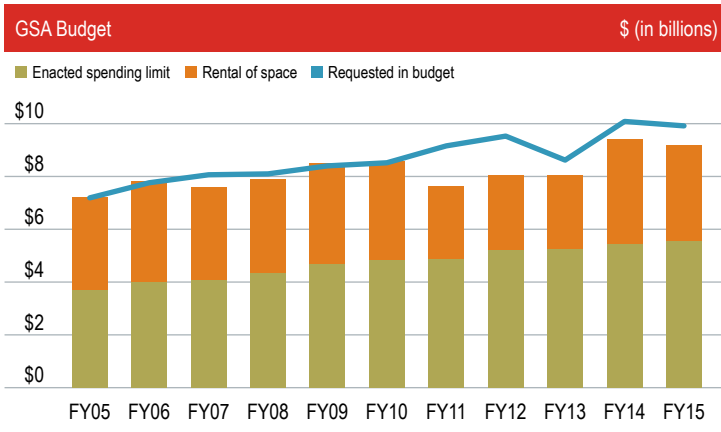
	2009	2013	2014	Increase ('13-'14)
Individual income taxes	915.0	1,316.0	1,394.6	6.0%
Social insurance taxes	891.0	948.0	1,023.9	8.0%
Corporate income taxes	138.0	274.0	320.7	17.0%
Other	160.0	237.0	281.6	18.8%
Total	2,104.0	2,775.0	3,020.8	8.9%

- Outlays increased marginally by 1.4% to 3.5B

- Deficit now accounts for 2.8% of the country's gross domestic product, the lowest level since 2007



GSA spending overview



The Financial Services and General Government Appropriations Bill for FY 2015 proposed authorizing the GSA to spend \$9.1 billion out of the Federal Buildings Fund, a 7.9 percent reduction from the FY 2015 Budget request. Unlike the FY 2014 appropriations, the FY 2015 bill fully funds the GSA's lease obligations.

In addition to fully-funding lease obligations, the bill also recommends \$100,000,000 for consolidation activities provided the consolidation reduces annual rent, does not exceed \$10,000,000 in costs and has an approved prospectus. Funding consolidations could allow agencies to evaluate space needs and make longer term leasing decisions.

0.14%

Of the total federal budget is spent on rent

0.26%

Of US budget represented by GSA

Why do you care?

GSA spending will remain under strict scrutiny, putting pressure on the leased portfolio



Defense spending

Defense spending is largely concentrated in Northern Virginia. Future defense spending prioritizes investments in research and development at the expense of cutting outdated programs, creating a smaller, more agile, flexible Joint Force.

Regular discretionary funding



↑ \$201.8M
more than the President's Request

↑ \$4.1B
more than the FY 2014 enacted level

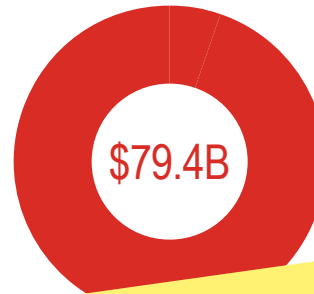
Favorable

projected procurement funding

\$175M

for the Defense Rapid Innovation Program

Overseas Contingency Operations (OCO) or war funding



↓ \$85B
FY 2014 appropriations provided for OCO

Why do you care?

Long-term spending priorities will drive future space needs

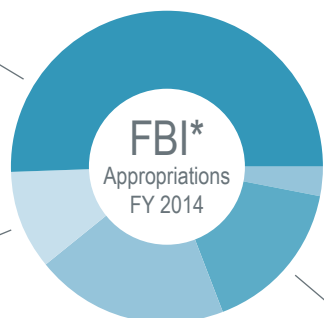


Civilian cybersecurity

Increasing cyber-attacks on federal and civilian information systems has led to a national focus to build a stronger national cybersecurity infrastructure. Intelligence activities have traditionally been focused in Northern Virginia, yet civil operations may also develop in Suburban Maryland around Fort Meade.

\$8.3B

for FBI national security programs and investigations of cyberattacks, violent gang crime and financial and mortgage fraud; \$1B less than requested.



\$3.3B

for counterterrorism and counterintelligence initiatives

\$2.6B

for Criminal Enterprises and Federal Crimes

\$1.7B

for intelligence activities

\$576M

for Criminal Justice Services



Office of the Chief
Information Officer

\$27M

of the \$44.3M is for cybersecurity requirements of the bureau

\$722M

FBI FY 2015 budget request for cybersecurity

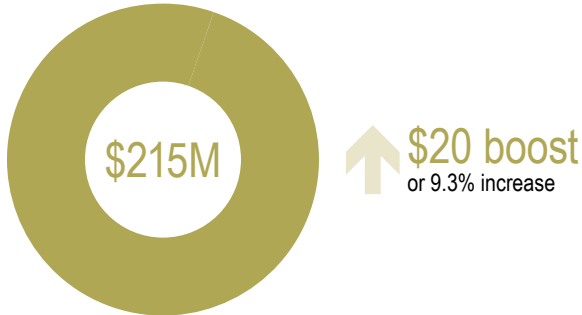
* The FBI would be directed to continue to support its Next Generation Cyber initiative and cyber task forces



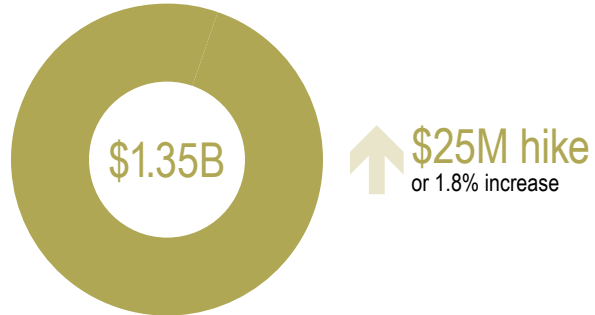
Financial regulation

As a result of the Dodd-Frank financial reform law, passed in 2010, financial regulation is expected to increase. Many agencies face expanded workloads, yet have not been able to staff the expanded responsibilities.

Commodity Futures Trading Commission



Securities and Exchange Commission

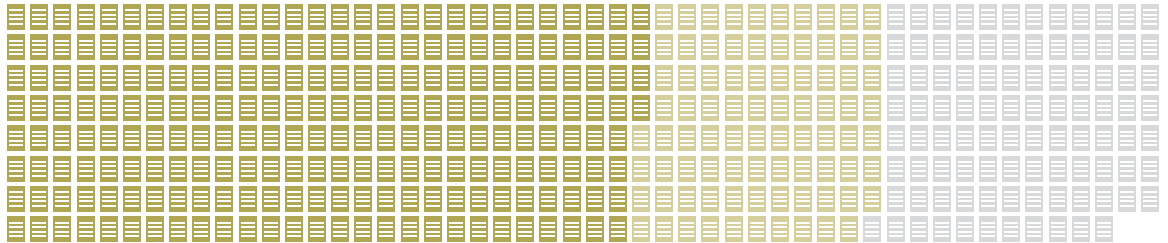


Dodd-Frank:

220 out of 398 rules have been passed

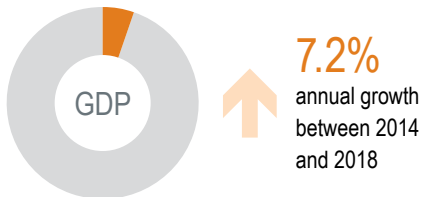
■ 220 passed

■ 95 not yet proposed



Healthcare

Continued implementation of the Affordable Care Act, in combination with an aging population, is leading to increased spending on health care programs. Administration of these programs could lead to employment growth.



Spending on major health care programs – Medicare, Medicaid, the Children's Health Insurance Program and subsidies for health insurance – is projected to increase by 31.9 percent by 2018, accounting for 5.3 percent of GDP

Department of Veterans Affairs



Department of Health and Human Services

85,234
total employees



38,101 employees
are located within the Washington, DC MSA, the largest cabinet-level agency employment within the region, with the majority located in Suburban Maryland

4,000+
real property assets

3,500 buildings
total 54M s.f.



Owned
2,700 buildings or 32M s.f.

Leased
800 buildings or 22M s.f.

Veterans healthcare



8.92M
receiving care



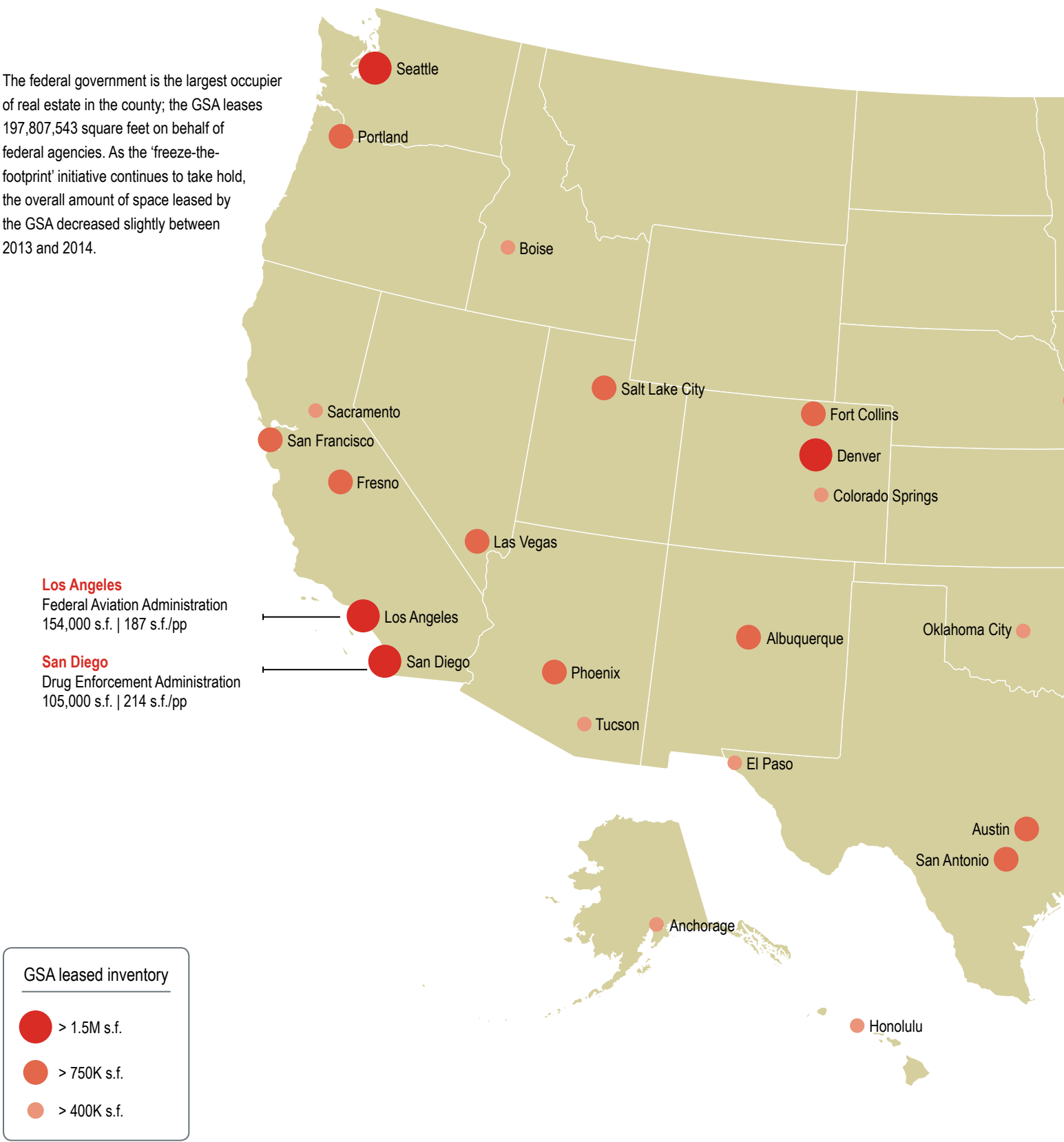
820
VA community-based
outpatient clinics

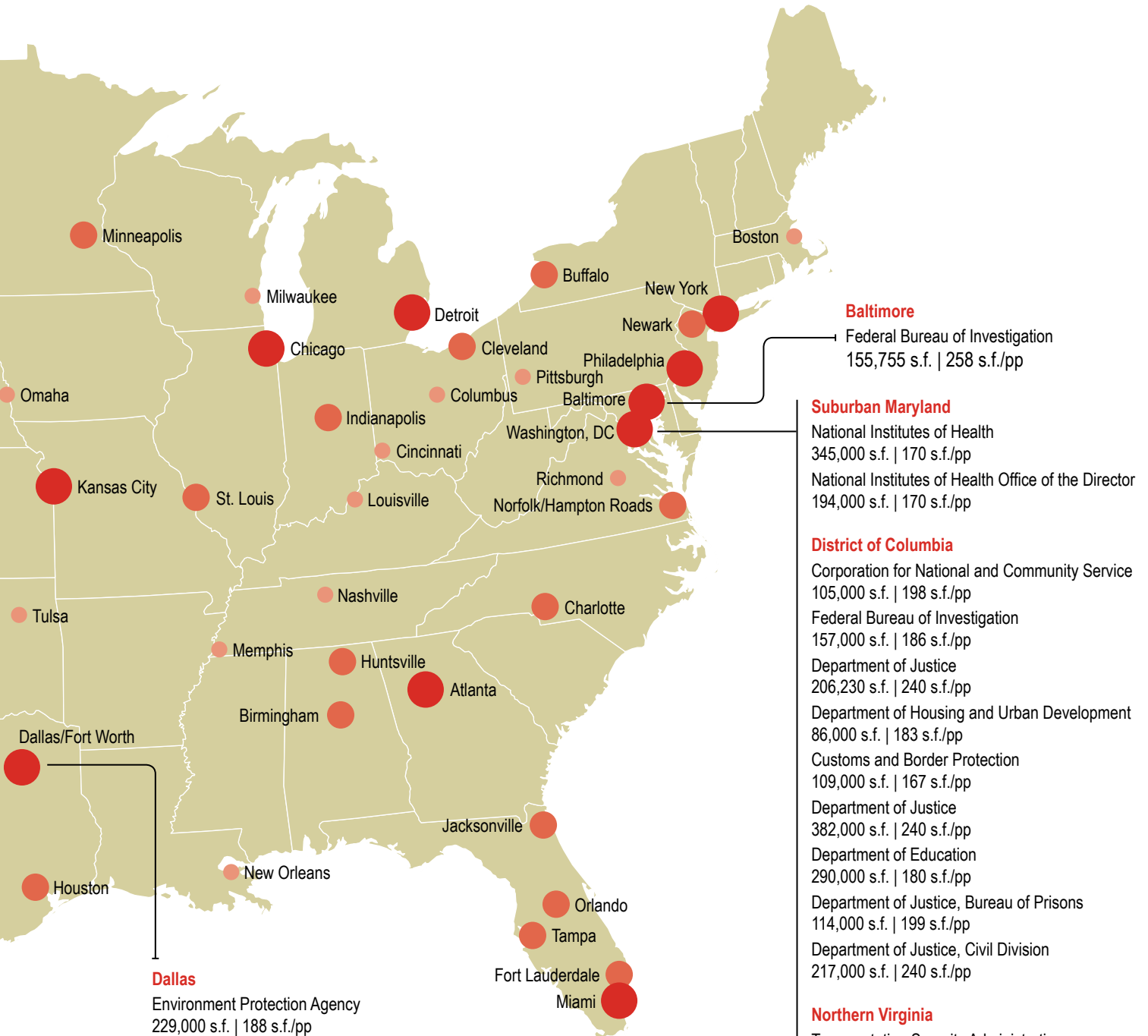


150
VA hospitals

Federal market landscape and upcoming lease prospectuses

The federal government is the largest occupier of real estate in the country; the GSA leases 197,807,543 square feet on behalf of federal agencies. As the 'freeze-the-footprint' initiative continues to take hold, the overall amount of space leased by the GSA decreased slightly between 2013 and 2014.





U.S. federal workforce

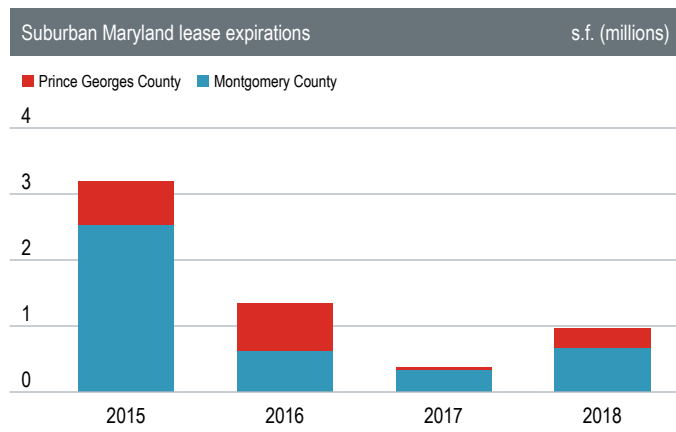
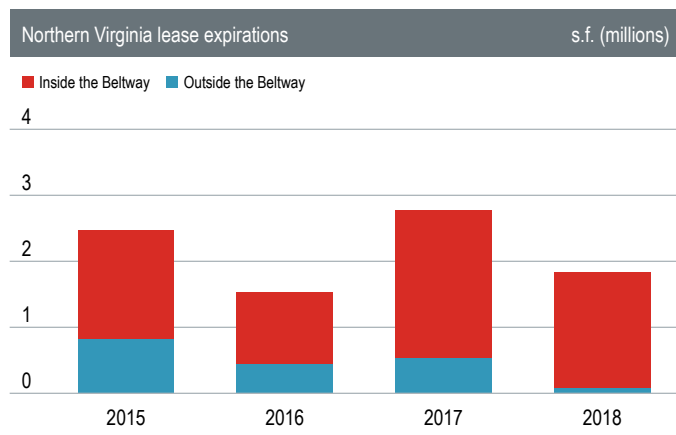
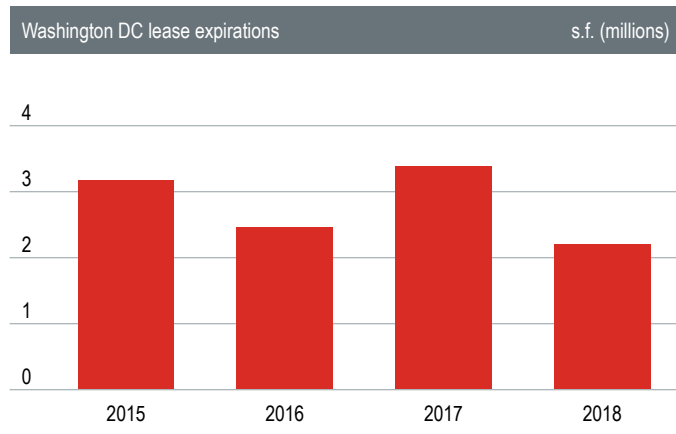
	Federal workforce (ths)	12 month net change (ths)	12 month % change	Average rent
Albuquerque	14.3	-0.1	-0.7%	\$14.69
Atlanta	44.4	0.3	0.7%	\$20.45
Austin	10.1	-1.6	-13.7%	\$31.07
Baltimore	51.5	0.8	1.6%	\$22.33
Boston	35.6	-0.4	-1.1%	\$29.80
Charlotte	6.7	0.2	3.1%	\$22.32
Chicago	53.1	-0.7	-1.3%	\$28.60
Cleveland	18.1	-0.1	-0.5%	\$19.46
Dallas	43.2	-0.8	-1.8%	\$22.52
Denver	27.4	-0.5	-1.8%	\$24.15
Detroit	27.5	0.6	2.2%	\$18.43
Houston	27.2	0.0	0.0%	\$30.91
Indianapolis	16	0.2	1.3%	\$17.72
Jacksonville	16.4	0.0	0.0%	\$18.39
Kansas City	25.7	0.2	0.8%	\$17.85
Las Vegas	12.2	-0.4	-3.2%	\$19.02
Los Angeles	57.1	-0.6	-1.0%	\$33.78
Miami	32.7	-0.2	-0.6%	\$32.70
Minneapolis	19.9	0.1	0.5%	\$24.44
New York	105.9	-0.2	-0.2%	\$64.91
Norfolk/Hampton Roads	49.3	-1.1	-2.2%	\$19.06
Orlando	12.2	0.2	1.7%	\$19.91
Philadelphia	50.2	-1.4	-2.7%	\$25.09
Phoenix	21.3	-0.1	-0.5%	\$21.11
Salt Lake City	11.9	0.3	2.6%	\$19.24
San Antonio	32.4	-2.0	-5.8%	\$21.93
San Diego	45.8	0.0	0.0%	\$27.60
San Francisco	31.7	-0.1	-0.3%	\$60.91
Seattle	33.5	-0.6	-1.8%	\$31.23
Tampa	22.7	0.2	0.9%	\$22.06
Washington, DC	366	-5.0	-1.3%	\$36.16
United States	2711	-12.0	-0.4%	\$30.05

U.S. federal market landscape

Leased space by market

MSA	GSA leases	(year-over-year)	(2015–2017)	(% of portfolio expiring)		
		Change	Lease expirations	2015	2016	2017
Washington, DC	58,690,033	-0.1%	21,507,451	15.5%	9.9%	11.2%
Kansas City	8,169,031	0.5%	1,467,268	3.2%	1.2%	13.5%
New York	6,620,559	-1.8%	2,544,403	20.0%	15.4%	3.0%
Atlanta	5,624,491	-0.9%	1,241,330	2.6%	4.2%	15.3%
Philadelphia	5,443,179	0.7%	1,097,698	7.8%	9.2%	3.1%
Dallas-Fort Worth	3,824,926	-0.7%	1,665,339	12.4%	3.3%	27.8%
Denver	3,679,771	-2.9%	1,050,501	11.9%	13.8%	2.9%
Baltimore	3,673,940	-6.1%	688,796	15.5%	1.6%	1.6%
Chicago	3,394,602	-0.1%	973,434	11.3%	9.2%	8.2%
Miami	3,362,510	0.3%	780,128	6.5%	9.6%	7.2%
Los Angeles	3,355,866	-2.0%	1,091,479	9.2%	16.9%	6.4%
Seattle	2,945,368	23.3%	772,731	18.2%	3.4%	4.6%
San Francisco	2,286,304	0.1%	1,089,052	17.5%	18.6%	11.5%
Detroit	2,281,841	0.7%	990,061	27.7%	4.9%	10.8%
San Diego	1,859,308	0.2%	637,715	9.3%	15.5%	9.5%
Hampton Roads	1,764,487	3.9%	381,193	6.9%	5.6%	9.1%
Phoenix	1,752,708	-0.8%	405,973	1.9%	11.6%	9.6%
Cincinnati	1,638,483	2.2%	289,885	9.1%	4.0%	4.6%
Houston	1,598,732	0.5%	526,565	6.2%	10.3%	16.5%
San Antonio	1,415,606	-6.8%	218,874	7.8%	3.2%	4.4%
Boston	1,404,426	-13.3%	449,527	11.0%	4.5%	16.6%
St. Louis	1,366,894	6.6%	299,674	7.6%	3.5%	10.9%
Fresno	1,356,919	-1.2%	88,871	4.8%	1.4%	0.3%
Portland	1,293,203	-15.3%	466,464	8.6%	17.4%	10.1%
Minneapolis	1,290,569	-1.5%	793,839	23.9%	29.5%	8.0%
United States	197,807,543	-0.3%	59,332,323	12.0%	8.6%	9.4%

Mid-Atlantic region overview



Washington, DC

With a leased inventory totaling 24.4 million square feet, GSA leases account for just over 20.0 percent of the office space within the District of Columbia. The federal government signed some of the largest leases in the District of Columbia; however, the executed leases lacked the term traditionally expected from the federal government. Under pressure to reduce the number of holdovers in the lease portfolio, yet unable to commit to long-term leases, GSA relied on short-term extensions to resolve the majority of lease expirations in 2014. For example, the Department of Education signed an extension for 314,243 square feet at 550 12th Street, SW. The agency is planning a larger consolidation, which will reduce its footprint from 502,329 square feet to 290,000 square feet, dropping the utilization rate from 335 square feet per person to 180 square feet per person.

Longer-term deals were rare, and landlords displayed a willingness to compete aggressively for federal leases with longer term. Most notably, The United States National Labor Relations Board signed a 10-year lease for 143,116 square feet at 1015 Half Street, SE. Underscoring the drive for efficiency, the new space is roughly half the agency's previous footprint at 1099 14th Street, NW in the East End. New federal procurements highlighted a drive for efficiency, albeit with new caveats. As some procurements sought to push utilization rates to 150 square feet per person, GSA placed increased emphasis on ceiling height requirements, at times as high as nine-finished-feet. These higher ceiling height requirements made it difficult for older buildings in the traditional federal enclaves to compete for federal procurements.

The GSA's FY14 Omnibus Appropriations for Consolidation Activities provided the Department of Health and Human Services the opportunity to make future space decisions, allowing the agency to ultimately consolidate into the Mary E. Switzer Building in Southwest. This consolidation project enabled the agency to cancel a new procurement and move into space owned by the federal government.

As GSA has over 3.8 million square feet of leases set to expire over the next 12 months, the agency will continue to grapple with finding efficiency, while attempting to plan larger consolidations. The current paradigm in leasing has made it increasingly difficult for incumbent buildings to compete for requirements, indicating that as GSA becomes able to commit to longer-term deals, the number of relocations may increase.

Northern Virginia

Following the announcement of the relocations of the National Science Foundation and Fish and Wildlife Service to Hoffman Town Center in Alexandria and Skyline in Baileys Crossroads, respectively, federal leasing activity was limited in Northern Virginia throughout 2014. In the largest deal in Northern Virginia, Department of Defense extended its 606,575-square-foot lease at 200 Stovall Street in Alexandria; the agency has occupied that space for over 30 years.

As GSA runs more 'lowest-cost, technically-feasible' procurements, the ability of landlords to provide the most aggressive cost savings have driven some relocations. For example, the Mineral Management Service relocated to Loudoun County from Herndon, taking 82,116 square feet at 45600 Woodland Road. The agency reduced its footprint by over a third in the relocation. The opening of the Silver Line has expanded the markets in Northern Virginia that can compete within delineated areas for Metro-proximate locations, increasing competition for procurements.

The largest upcoming federal transaction is the procurement for the headquarters for the Transportation Security Administration. The agency is currently housed in several buildings across Northern Virginia, notably 601 and 701 South Clark Street in Crystal City. The prospectus for the new headquarters dropped the utilization rate to 153 square feet per person and included stipulations making it very difficult for the incumbent location to compete for the procurement. For example, the incumbent location would be required to locate and pay for swing space while renovating the current space.

Why do you care?

The push for cost savings in GSA's portfolio will disproportionately affect Metro DC, where GSA leases a total of 57.2M s.f.

Suburban Maryland

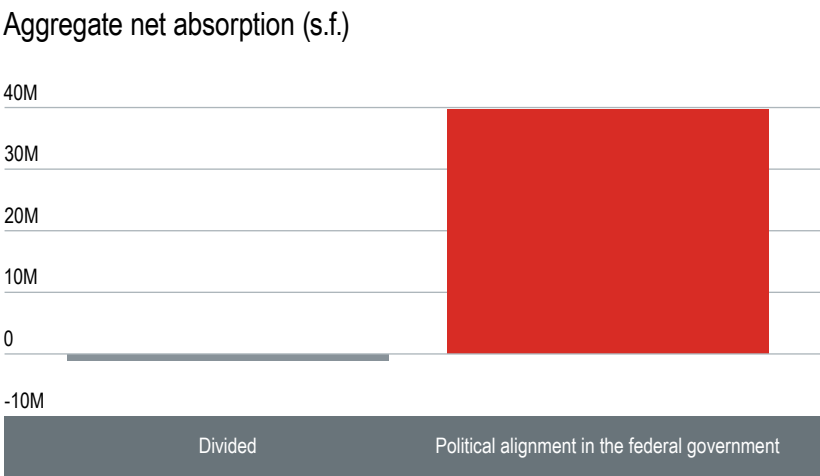
Federal leasing activity in Suburban Maryland remained largely dormant throughout 2014. The largest deal executed was The National Institute of Child Health and Human Development's 84,606-square-foot lease at 6710 Rockledge Drive; the agency opted to relocate from 6100 Executive Boulevard. Unlike most other federal transactions, the transaction did not involve contraction.

The Nuclear Regulatory Commission – which made headlines for taking excess space at Three White Flint in 2013 – signed a 347,922-square-foot renewal at its existing space, Two White Flint. The agency was forced to sublet the excess space to other federal tenants; the FDA agreed to sublease 186,313 square feet in Three White Flint. The move will let other FDA leases expire while the agency completes a consolidation at the White Oak campus in Silver Spring, ultimately taking the agency from leased to owned space.

In 2014, GSA released prospectuses for the National Institutes of Health (NIH). Two prospectuses seek to consolidate leases for the NIH and NIH Office of the Director (OD). The new leases aggressively reduced the footprint of NIH from 443,764 square feet to 345,000 square feet and the OD from 250,144 square feet to 194,000 square feet. The replacement leases will likely see the NIH relocate from its current space in Rock Spring. Rock Spring has been hit particularly hard, by NIH relocations, including National Institute of Allergy and Infectious Diseases' (NIAID) move into 5601 Fishers Lane in Twinbrook, a 490,998-square-foot build-to-suit announced in 2011.

In the competition for the Federal Bureau of Investigations headquarters, two sites in Prince George's County were selected among the finalists. Both sites, located in Landover and Greenbelt, remain in competition for the 2.1-million-square-foot requirement.

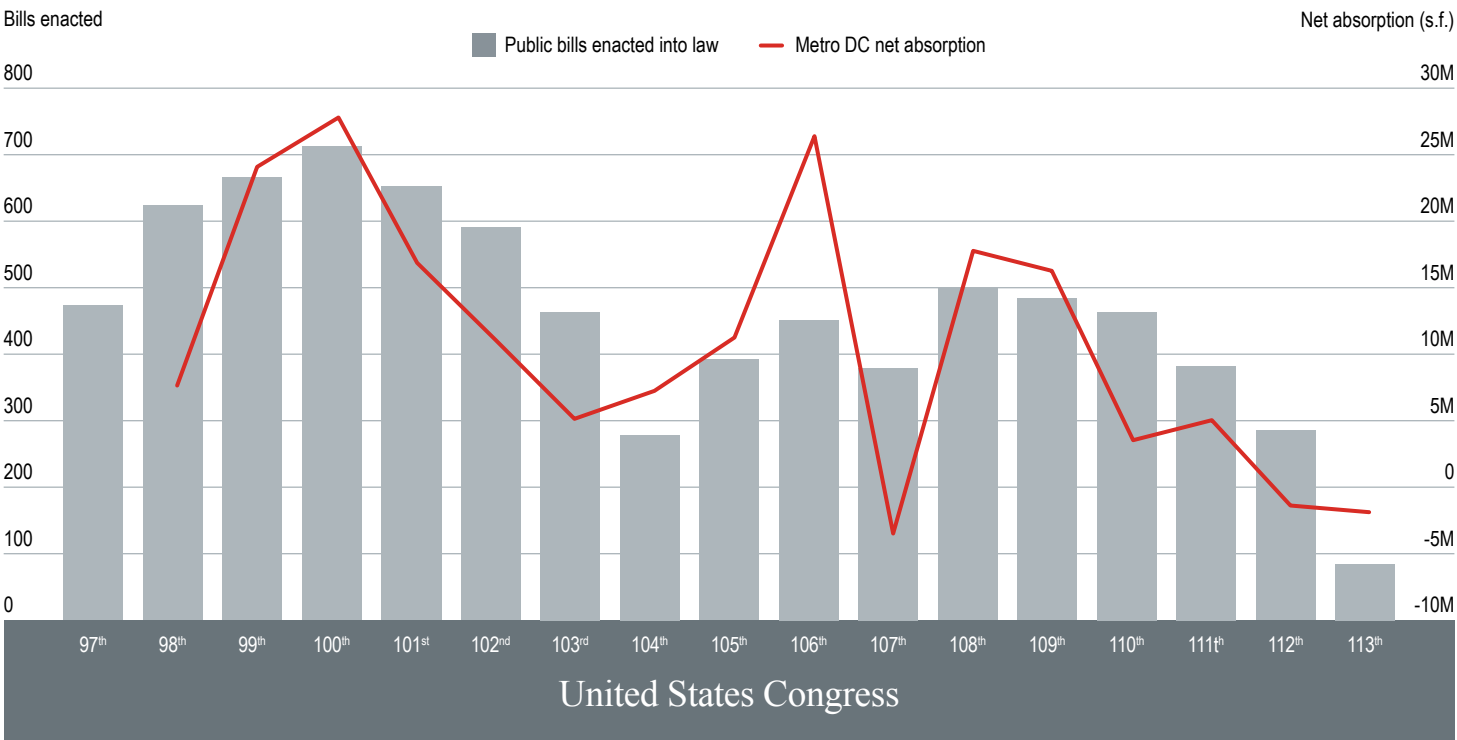
Political clarity is key to office market performance



Why do you care?

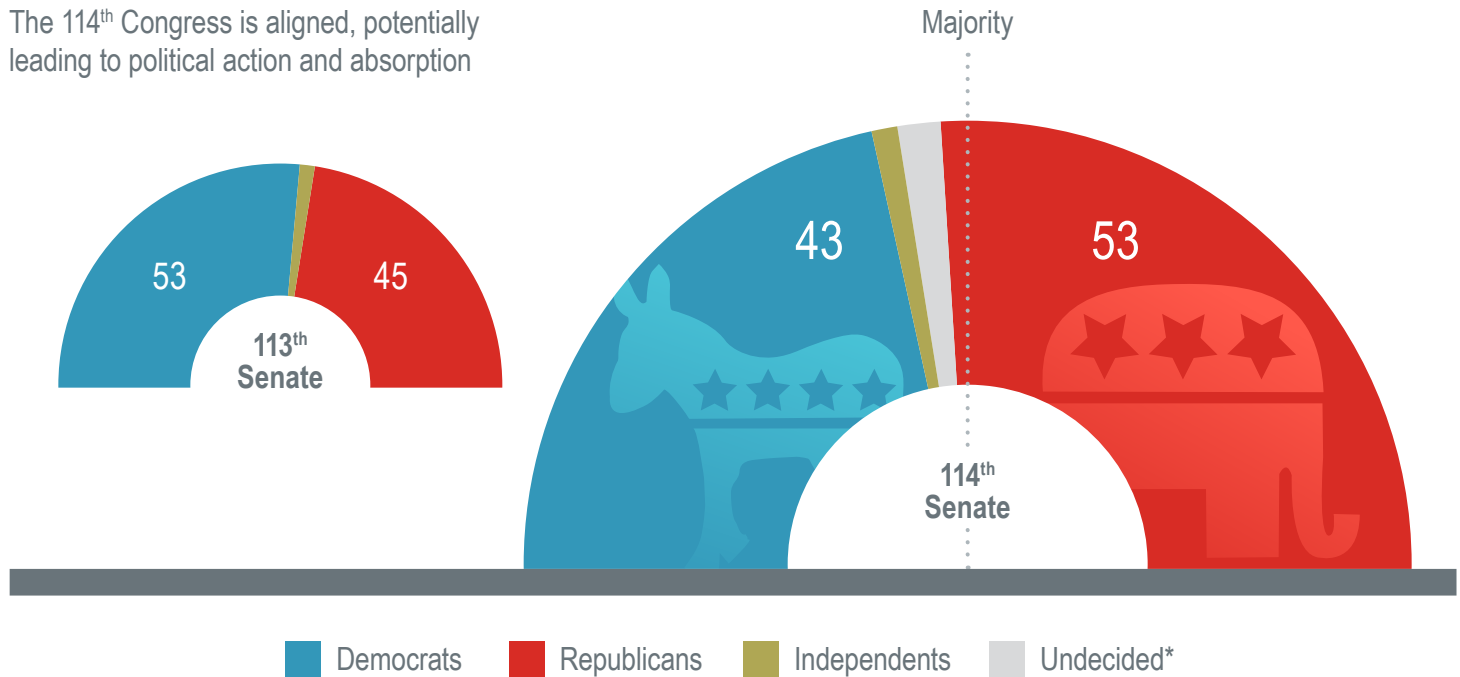
Metro DC's real estate markets thrive on political alignment

Legislation fuels Metro DC net absorption



Balance of Power in the House and the Senate

The 114th Congress is aligned, potentially leading to political action and absorption



Tenant demand in Metro DC is highly correlated with the alignment of Congress and the Presidency. When one party is in control of both the executive and legislative branches, the resulting political agreement enables the easy passage of laws and the establishment of clear fiscal policies.

Over the past 12+ years, the Metro DC office market has absorbed 39.1 MSF when Congress and the Presidency have been in alignment (2003-06 and 2009-10) and lost 1.9 MSF of occupancy when there has been division (2001-02; 2007-08 and 2011-14), making political clarity the most important predictor of office market performance.

The government shutdown – resulting from Congress' inability to negotiate a spending plan to fund the government in 2013 – epitomizes the political gridlock that has stifled the Washington, DC office market over the past few years. Continued gridlock has the potential to further delay GSA decision-making, postpone leasing decisions and reduce user agencies' mission growth.

After the midterm elections, Republicans took control of the Senate with a sweep of at least eight Senate seats. By crossing the critical 50-seat mark, Republicans now hold a majority in both the House and the Senate. While President Obama risks the political backlash of blocking legislation as it comes off a newly-aligned Capitol Hill, Congress must also legislate efficiently in an attempt to reassure voters that they have the ability to govern. Ultimately, the shift in Congressional power from one party to another could potentially herald a brief period of compromise, where Congress sends bills with some bipartisan consensus to President Obama as both parties turn their attention to the 2016 elections.

The federal financial difficulties of the past couple of years have impacted the market profoundly since late 2011 and present unique challenges and opportunities to the market moving forward. However, political compromise on a long-term budget is likely to spur future leasing activity.

* Undecided at time of writing

Major themes in federal leasing



The evolution of federal leasing

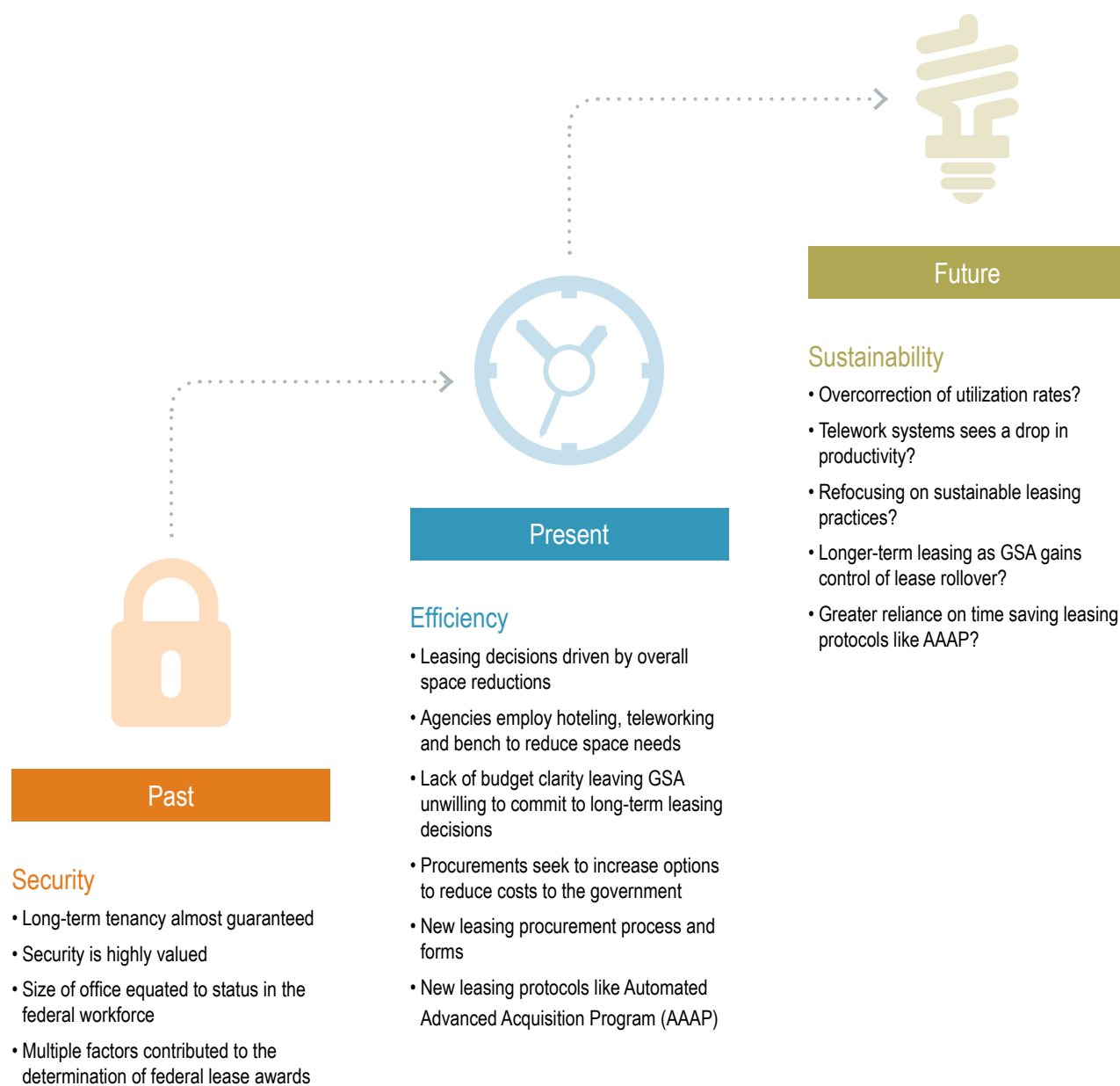
The federal real estate market has been stuck in a transitional period since the introduction of the 'freeze-the-footprint' initiative in 2010. In contrast to the stimulus-related growth between 2008 and 2010, GSA now faces a shrinking federal workforce, technological advancement and a federal initiative to reduce the entire leased portfolio by 20.0 percent—all without a budget and appropriations to make long-term decisions.

GSA's current policy and operational focus is on reducing the total amount of space in its leased portfolio. Following the lead of many private sector tenants, the federal real estate market has adopted recent design trends—open floor plans, hoteling and hot desks—leading to drastic reductions in utilization rates and the amount of square footage required. While the federal government is typically slow to adopt private sector trends, the new space utilization model has complemented the initiative to reduce the amount of real estate leased by the federal government. In addition, GSA is reconfiguring federally-owned buildings to can accommodate agencies coming from leased locations.

While efficiency defines GSA leasing decisions, the space reduction trend has, in many ways, been artificially superimposed on the federal workforce. As agencies seek ways to operationalize the reductions by compressing per person space utilization, procurements for long-term replacement leases are resulting in increased relocations as the target utilization rates decrease the traditional financial advantages that incumbent buildings hold. Tenured federal employees accustomed to individual offices are being forced to inhabit 150-square-foot cubes as a part of an open floor plan. Some agencies are struggling with these changes and have hired change consultants to assist with acclimating to the new spaces.

Policies like teleworking, hoteling and alternate work schedules have been a key component of efforts to reduce the need for federal leased space. In 2014, 29.0 percent of the federal workforce in the Federal Employee Viewpoint Survey reported teleworking, up from 19.0 percent in 2011. These practices are still playing out across both the private and public sectors, and recent inquiries into federal teleworking programs question the productivity associated with these programs.

Of course, the real question is what are the next trends for federal leasing? The next trend in GSA leasing could be determined by external forces outside of GSA Central Office. For example, events in the Middle East, the spread of the Ebola virus, economic stability—all of these issues carry their own specific, inherent impact on the government's relationship to real property and their scopes cannot be predicted. The government has a tendency to grow in times of crisis. Therefore, one prediction is that as events overseas escalate and America increases its presence abroad, the infrastructure required to support these efforts will correspondingly increase. This increase could result in an expansion in the federal presence, potentially offsetting the reductions that have occurred within the past couple of years.



End of lease behavior

In recent years, GSA has moved to signing short-term lease extensions, instead of running full and open procurements for long-term leases. Consequently, the government's real property costs significantly increase as federal tenant pays a premium for shorter-term deals that do not provide landlords with certainty or confidence. The reactionary tendencies of the federal government, such as beginning the lease procurement process after the point where a long-term lease procurement is feasible, has become an area of focus for GSA's oversight committees on Capitol Hill.

GSA leased space nationwide has continued to increase over time, but has dramatically slowed its pace in 2013 and 2014.

Holdover was a greater problem in 2012 than it is today.

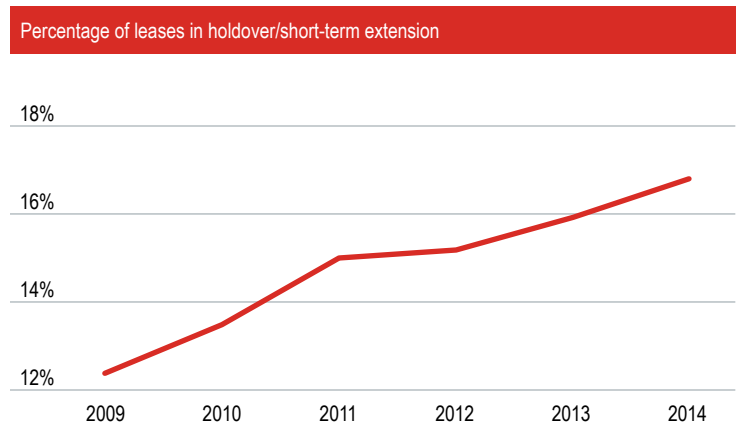
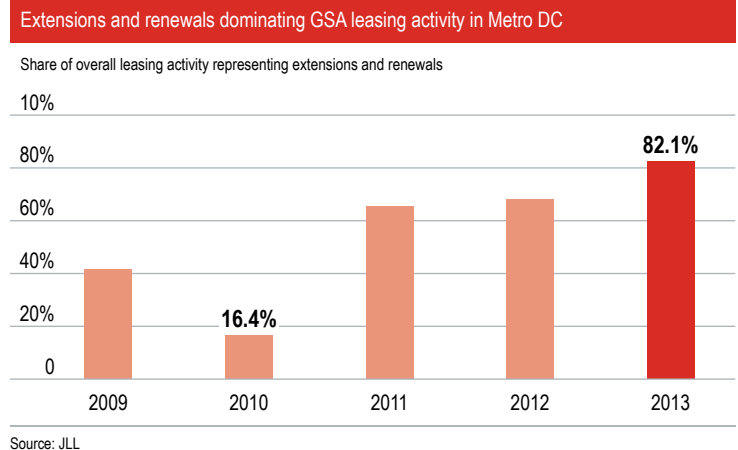
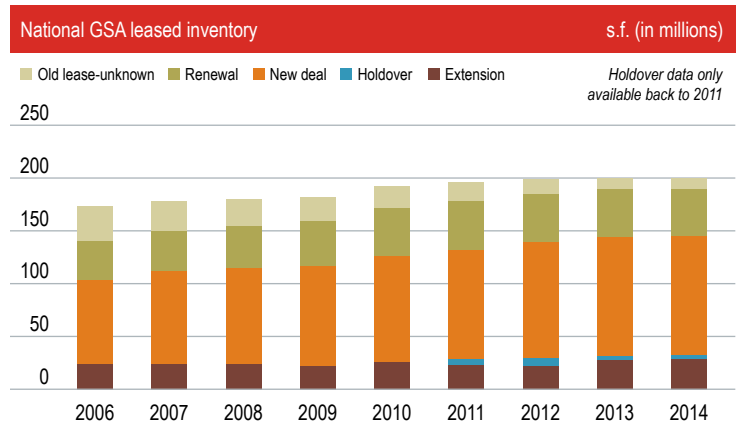
Extensions have steadily increased over time, from 23.6 million s.f. in 2006 to 28.6 million s.f. in 2014 (21.2% increase).

The House Committee on Transportation and Infrastructure held a hearing in July of 2014 on GSA's leasing program and to examine opportunities for taxpayer savings in today's real estate market. One of the main focus points of the discussion was GSA's negotiation behavior at the end of their existing leases. Norman Dong, the Commissioner of the Public Buildings Service, along with real estate heads for six of GSA's largest tenant agencies testified at the hearing.

The percentage of leases that GSA has let fall into holdover, or executed short-term extensions above market rates, has steadily increased since 2009. In the most recent data available, 2.3 percent of GSA leases nationally were in holdover and 14.5 percent were under a short term extension.

Why do you care?

GSA is reluctant to make long-term decisions, leading to an increased reliance on short-term leases



Why do you care?

Short-term extension
are replacing holdovers,
leading to substantial
near-term rollover

Bow wave: expiring lease pileup

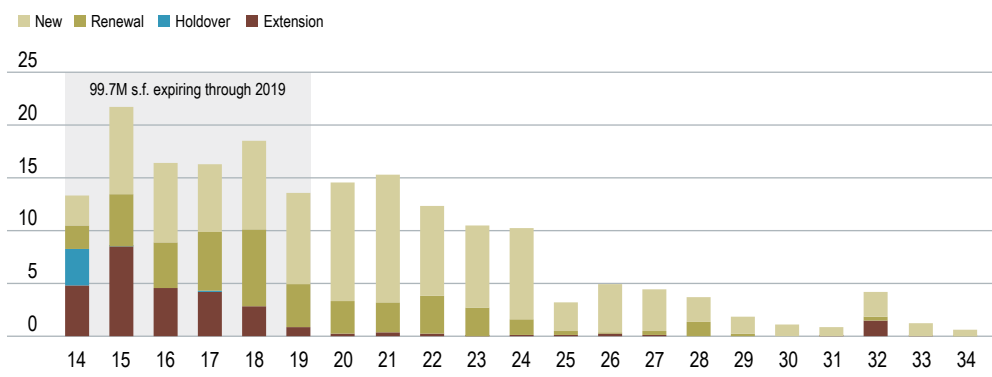
GSA struggles to keep up with its leasing activity causing an increased roll-over of leases expiring in the short term, often referred to as the “bow wave.” Over the past few years, GSA’s tendency to avoid long-term commitments and sign short-term extensions has caused the ‘bow wave’ to grow.

Just over half the entire GSA lease portfolio is set to expire in the next five years, however, between 2013 and 2014, the ‘bow wave’ shrank very slightly, with the square footage of leases expiring in the next five years dropping just below 100.0 million square feet.

In the National Capital Region, the near-term rollover is even more pronounced - 58.1 percent of the lease inventory in the NCR will expire in the next five years, totaling approximately 33.2 million square feet.

Lease expirations (August 2014)

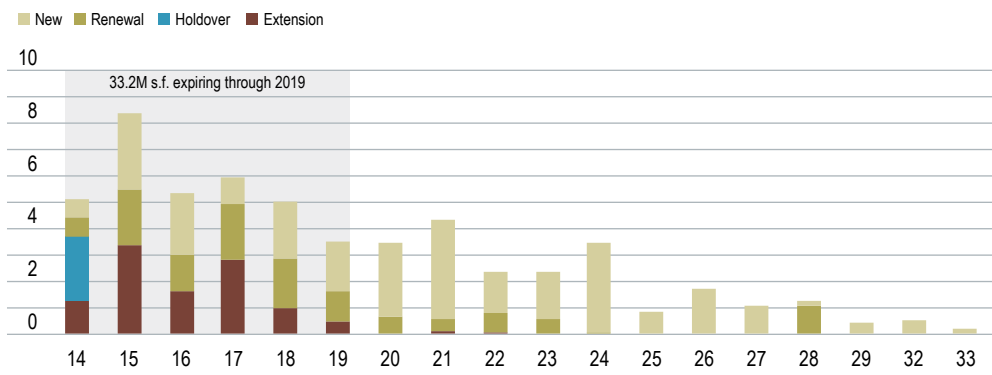
s.f. (in millions)



- In the next five years, 99.7M s.f. of GSA leases will expire, which represents just over half of the national GSA lease inventory (50.4%). This is a slight reduction from the “bow wave” of 101.6M s.f. expiring in the next five years in 2013.
- Nationally, as of August 2014, holdovers accounted for 1.7 percent of the GSA leased portfolio. Across the national lease inventory, leases in holdover increased marginally by 0.9 percent.

Lease expirations (August 2014) – National Capital Region

s.f. (in millions)



- In the next five years, 33.2M s.f. of GSA leases will expire in the National Capital Region, which represents 58.1 percent of the regions GSA lease inventory. Over the past year, GSA has decreased the “bow wave” slightly. In 2013, 35.5M s.f. of lease were expiring in the next five years.
- Nationally, as of August 2014, holdovers accounted for 4.2 percent of the GSA leased portfolio. Moreover, nearly 10M s.f. will be expiring in the National Capital Region in the next 12 months, representing 17.5 percent of the GSA lease inventory. The percentage of GSA leases in holdover in the NCR increased 16.7 percent over the past year to 2.4M s.f..



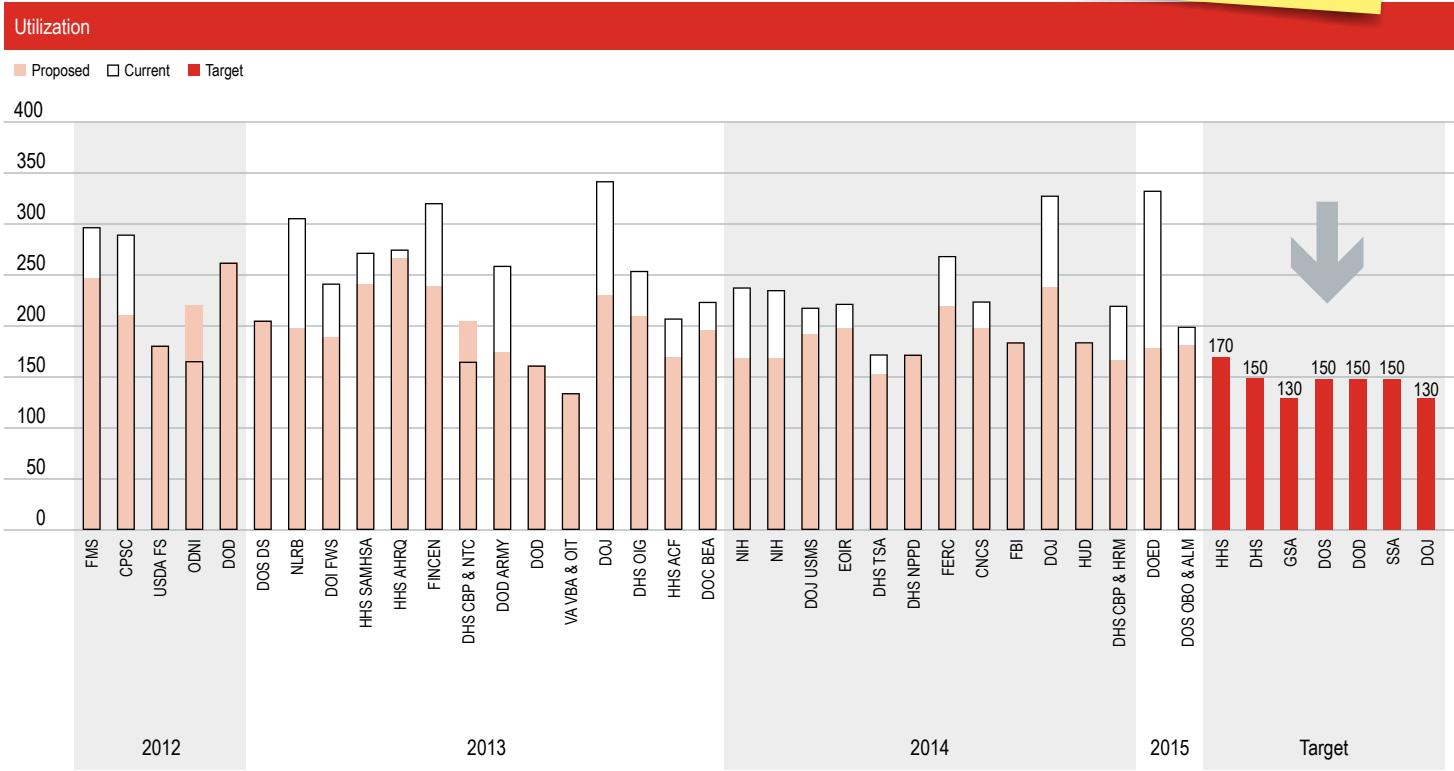
Discussion of future GSA leasing priorities

Without clarity on agency budgets—or adequate funding to implement moves, consolidations and restacks—federal tenants were forced to delay space decisions or execute short-term renewals to ride out the uncertainty. With the passage of the spending bill on January 16, 2014, increased certainty regarding agency funding had a positive effect on the federal and quasi-federal markets. In the first half of 2014, the national federal office market enjoyed increased lease flow and a greater planned procurement pipeline.

Recent GSA lease prospectuses highlight the shift in utilization rates (UR). Complementary agencies and user-groups are consolidating together under large lease deals. Programs like teleworking and office hoteling continue support efforts by GSA tenants to leverage emerging technologies. Federal tenants are typically shedding 15.0 percent or more when they execute new leases, requiring reconfiguration to meet new UR specifications.

When facing lease expiration measures by tenants to right-size footprints have resulted in an uptick in relocations. Incumbents with older buildings (which historically enjoyed consistent federal renewal certainty) are forced to incorporate space reconfiguration costs into their renewal pricing proposals. This can erode the incumbent's price advantage over newly proposed competitive space—triggering a move.

Why do you care?
Incumbent locations are at a disadvantage under the new leasing priorities, a major disruptor in the federal leasing market





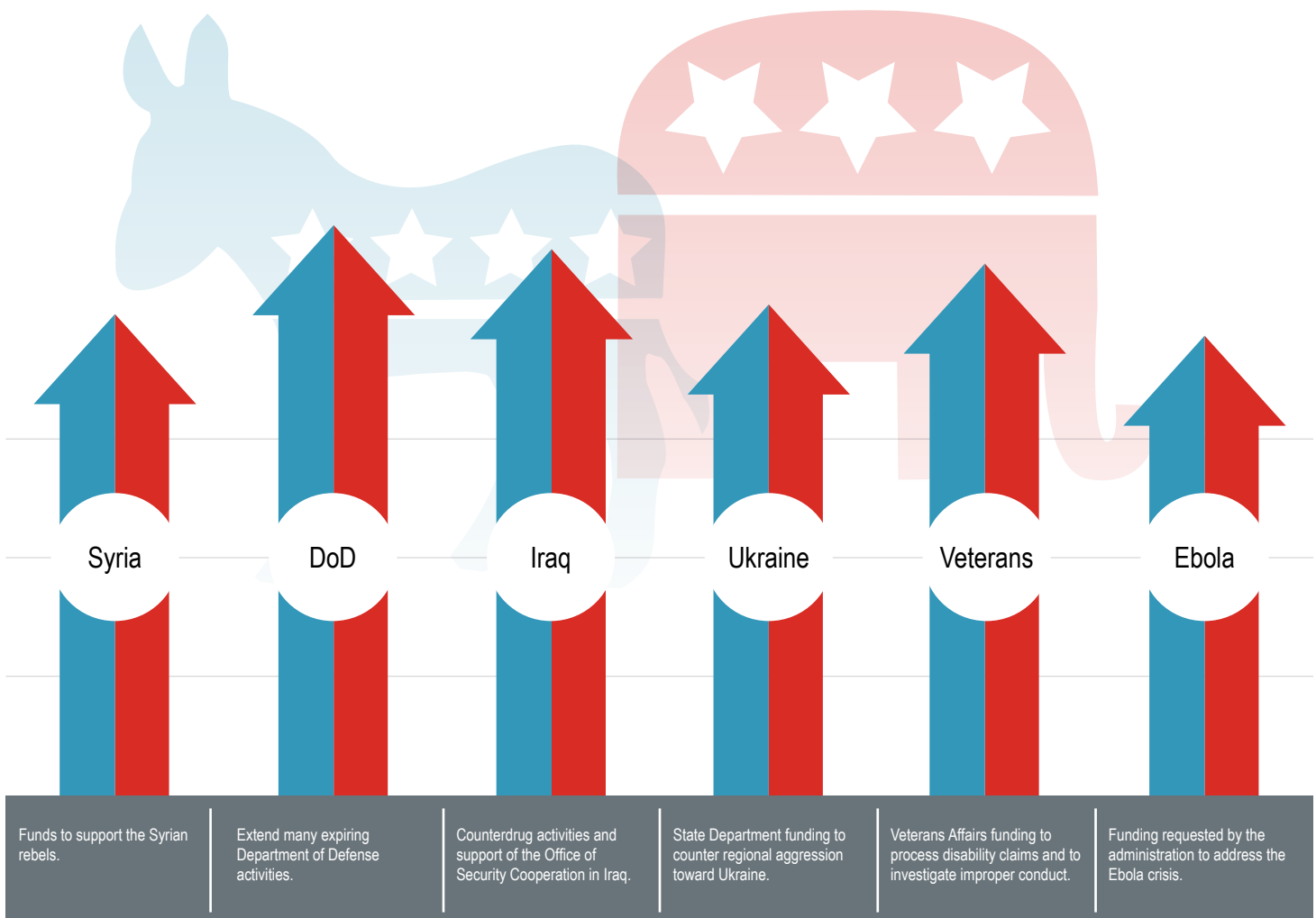
Why do you care?

The federal government is motivated into activity by crisis management

What makes the government act?

Despite continued gridlock over macro-budgetary priorities, there are always current world events that seem to drive pockets of federal leasing demand in both the short to mid-term. Post-9/11, Northern Virginia exploded with defense-related leasing activity. Shortly after, the newly-formed Department of Homeland Security was created and metro DC benefited from hurried and scattered leasing activity as DHS waded through a decade growing pains. Constitution Center, to this day, the most expensive federal building ever sold, was originally designed to house the newly beefed up Securities and Exchange Commission as the agency geared up for enforcing Dodd-Frank in response to the Great Recession.

Congress passed a continuing resolution in late September—funding the federal government through December 11, 2014 and avoiding a federal shutdown on October 1. The law's quiet passage underscores a new, less noisy approach to partisan budget politics. The bill sets the discretionary funding level for the federal government during CR period at an annual rate of \$1.012 trillion. While the FY 2015 budget has yet to be agreed upon by either the House or the Senate, the continuing resolution is an excellent example of current events shaping pockets of growth and spending within the federal government. For example, the CR included bipartisan support for the following policy areas:



Major federal leasing themes

■ The federal leasing market is undergoing a period of change as old market inertia and practices meet new market priorities, stakeholders and realities.

■ August through October 2014 saw a significant increase in an federal leasing activity due to internal pressure at GSA to achieve internal metrics to mitigate portfolio holdover by the end of the federal fiscal year. However, the leasing velocity was confined almost exclusively to short-term renewals and extensions (3 years or less).

■ Nevertheless, both the budgetary logjam and expiring lease rollover backlog have built up an unprecedented amount of short-term expiring leases and holdovers in the federal portfolio. GSA continues to struggle with managing this mounting problem.

■ Federal employment will continue to decline, as hiring freezes coupled with ongoing employee retirements reduces the number of federal employees across the country.

■ There is growing evidence to suggest that the government's flight toward telecommuting, hoteling and benching may have unintentional negative consequences on productivity and workplace satisfaction. There may be a market correction—away from the government's current utilization rate goals—looming in the medium to long term.

■ GSA and the federal government continue to tout major projects and portfolio overhauls plans. However, for the most part, there has yet to be any action related to these initiatives.

■ The federal real estate market remains preoccupied with determining which major projects and policies will become real opportunities: St. Elizabeths, Dodd-Frank, Cybersecurity, FBI Headquarters, 412 Authority, etc.

■ Political alignment in Congress will lead to a modest increase in legislation created on Capitol Hill. This is good news for Metro DC, as regional leasing velocity is heavily correlated with the number of bills enacted into law.

■ Partial space givebacks, relocations into federally-owned space, and contractions will continue to dominate the federal leasing market as agencies attempt to keep administrative expenditures low in an effort to preserve funds for mission related activities.

■ The government will continue to struggle with exploring opportunities to creatively address budget issues facing most agencies, including incorporating move costs and above-standard TIs into relocations. There will be more receptive market for these solutions than in the past, but implementation will remain difficult.

■ In today's leasing environment, owners and investors of federal real estate find themselves inundated with market data and metrics. It takes multi-disciplinary, specialized brokerage advisory services to translate the information, eliminate distractions and protect clients' investments.



JLL Government Investor Services

The Government Investor Services team at JLL is the premier provider for comprehensive federal real estate advisory services. Combining deep market experience and political tradecraft with superior research and financial analysis, we create certainty for our clients—driving value and confidence in an increasingly complex federal marketplace.



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The Government Investor Services team at Jones Lang LaSalle is the premier provider for comprehensive federal real estate advisory services. Combining deep market experience and political tradecraft with superior research and financial analysis, we create certainty for our clients—driving value and confidence in an increasingly complex federal marketplace.

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