March 29, 2017

MEMORANDUM TO: REGIONAL COMMISSIONERS, PBS
REGIONAL LEASING DIRECTORS
REGIONAL LEASE ACQUISITION OFFICERS

3/29/2017

X James C. Wisner

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Signed by: JAMES WISNER

FROM: JAMES C. WISNER
ASSISTANT COMMISSIONER FOR THE OFFICE OF LEASING - PR

SUBJECT: **LEASING ALERT (LA-FY17-07) – Net of Utilities Lease Structure**

1. Purpose.

This Leasing Alert provides the results of multiple studies and analyses related to net of utilities leases. It is GSA's standard to use a fully serviced lease structure, with the majority of GSA leases being fully serviced; however, there are limited opportunities for project teams to consider a net of utilities lease structure. Using a net of utilities lease structure may reduce energy consumption and energy costs for a tenant agency when multiple conditions are in place, however, savings may not be sufficient to offset all costs related to administering and managing them.

2. Background.

a. Key Conclusions and Findings:

The National Office of Leasing examined the benefits and challenges related to net of utilities leases from 2012 to 2016. Multiple studies and analyses were conducted to test the assumption that netting utilities from the lease provides tenant agencies with the motivation and financial incentive to reduce energy consumption. The National Office of

Leasing commissioned a reputable third-party consultant to conduct several studies over the past three years to assess the processes, costs, benefits, potential savings, and challenges related to net of utilities leases. Extensive outreach to PBS business lines and tenant agencies generated valuable insights and feedback about net of utilities leases. Multiple findings from these studies, analyses, pilots, and stakeholder feedback demonstrated that net of utilities leases do not result in consistent, long-term reductions in energy consumption and energy costs. Study findings demonstrated that savings in utility costs begin to outweigh administrative costs typically when a lease is at least 50,000 RSF in size. In limited situations where net of utilities leases resulted in reduced energy costs (and consumption), these savings were typically not enough to offset the added costs of administering, managing, metering, and monitoring net of utilities leases. As such, it is GSA's standard to use a fully serviced lease structure, with the majority of GSA leases being fully serviced.

Net of utilities leases are viable and beneficial in selective situations when specific conditions are in place. Project teams and Lease Contracting Officers (LCOs) should use a fully serviced approach unless a combination of these conditions are in place. Large lease size (>= 50,000 RSF) and full-building occupancy were identified as the most critical pre-conditions when considering the use of a net of utilities lease structure. Although having most of these factors present results in the higher likelihood of a viable net of utilities structure, each lease situation must be evaluated on a case-by-case basis.

i. Lease size is >= 50,000 RSF, with tenant agency being a 100% building occupant, and a high-energy user;
ii. Tenant agency has the infrastructure and administrative processes in place to effectively manage net of utilities leases;
iii. Tenant agency pays utilities directly -- versus through GSA;
iv. Tenant agency has the ability to accurately budget for fluctuations in energy costs and usage;
v. Strong tenant agency leadership buy-in and commitment to net leases exists;
vi. Lease is located in a deregulated market where GSA can buy utilities at a bulk discount on behalf of tenant agencies.

b. <u>Targeted Approach to Pursuing Net of Utilities Leases</u>:

Currently, only about 4% of GSA's 8,340 leases are structured as net of utilities, with the majority (approximately 96%) being fully serviced. 301 out of 8,340 leases are net of utilities, with GSA paying utilities for 289 of those leases, and tenant agencies paying utilities for 12 of those leases. Study findings demonstrate that savings in utility costs begin to outweigh administrative costs typically when a lease is at least 50,000 RSF in size. Approximately 10% (840) of GSA's leases are over 50,000 RSF, with only 360 of these being leases where a tenant agency has 100% building occupancy. Leasing and

Client Solutions personnel responsible for requirements development should evaluate the viability of net of utility leases early on in the requirements development and acquisition planning stage (before the solicitation/RLP is issued), with a focus on large leases where a tenant agency has 100% building occupancy. As this evaluation occurs, it is important for tenant agencies to be aware of both the benefits and challenges associated with net leases as identified below:

i. Benefits of Net of Utilities leases:
   - Tenant agency has the responsibility, accountability, and incentive to reduce energy consumption.
   - Financial risk can be transferred to the tenant agency if they pay for utilities directly.
   - There is potential for reducing tenant agency energy consumption and costs.
   - Some net of utilities successes have occurred with tenants whose agency has strong leadership buy-in for net of utilities leases, and who have adequate resources to administer them. However, in limited situations where net of utilities leases resulted in reduced costs (and consumption), these savings were typically not enough to offset all added costs.

ii. Challenges of Net of Utilities leases:
   - Resource/Administrative burden: Managing and monitoring net of utilities leases require substantial resources within PBS' Facilities Management, Contracting, Pricing, and Budget departments (when GSA procures utilities).
     - Up to 13 additional steps are involved with administering and managing a net of utilities versus a fully serviced lease (when GSA pays for utilities).
   - Budgeting uncertainty: Unpredictable energy needs make it difficult to accurately budget for utilities since two-year advance planning is required.
   - Higher risk to GSA: Budget authority may not be appropriated at the level requested, requiring the need to redirect funding.
   - Collection issues: The manually intensive process required to administer and manage net of utilities leases can result in limited reconciliations, under-collecting, and risks of errors and losses.
   - Delegation required: A delegation is needed from GSA for a tenant agency to procure utilities (FAR 41:103 (c)).
   - No guarantee of energy savings with a net of utilities lease structure: Although GSA's net leases were comparable in cost to Building Owners & Managers Association (BOMA) commercial averages, these leases consumed substantially more energy (+88%) and cost $0.80 more per RSF than GSA's federally owned space.

- Lessors may become less engaged: There is a reduced incentive for lessors to maintain a building or pursue energy efficient upgrades under a net of utilities lease structure since they are not directly responsible for utility payments.

c. Office of Leasing Impacts on Energy Efficiency and Utility Reductions:

GSA's leasing requirements will continue to promote energy efficiency and encourage reductions in utility consumption in a variety of ways, including the following:

- Lease Language: Energy efficient standards in leasing requirements are regularly updated to align with industry standards.
- Operating Expenses-Form 1217: Realty specialists are encouraged to carefully scrutinize and diligently negotiate with prospective lessors on the portion of operating costs attributed to utilities.
- Requirements Development/Acquisition Planning Evaluation: Evaluation of the viability of a net of utilities lease structure occurs early in the requirements development/acquisition planning stage – for large, 100% occupants (and specific situations outlined in 2.a.).
- Energy Disclosure by Lessors: The recent provision based on Executive Order 13693 requires lessors to regularly report monthly utility consumption data and benchmark their buildings (see Lease paragraph 6.04 "Utility Consumption Reporting").

3. Effective Date. This Leasing Alert is effective on the date of signature unless modified, cancelled, or reissued.

4. Cancellation. None.

5. Applicability. This Leasing Alert and its attachments apply to all GSA real property leasing activities.

6. Instructions and Procedures. The evaluation considerations list in Attachment 1 below identifies key factors for a project team to use to assess the potential for a net of utilities lease structure. This evaluation should occur early on in the requirements development stage to ensure that a possible net of utilities lease structure is appropriately considered and identified in the acquisition planning process. The decision of whether to pursue a net of utility lease structure should be made pre-solicitation (i.e., before the RLP is issued), and clearly outlined in the RLP paragraphs selected by the LCO. The LCO should select the appropriate RLP and Lease language/paragraphs associated with a net of utilities lease as instructed in the blue, hidden text.

Attachment 1: Net of Utilities Lease Structure – Evaluation Considerations at Requirements Development Stage (to be used by Leasing and Client Solutions personnel responsible for requirements development)

The National Office of Leasing examined opportunities to reduce energy consumption and utility costs within its 8,340 leased properties, 96% of which are currently fully serviced. It is GSA's standard to use a fully serviced lease structure; however, this evaluation list is to be used during the requirements development stage by Leasing and Client Solutions personnel responsible for requirements development to determine whether pursuing a net of utilities lease structure is advantageous for the government. A net of utilities lease structure is a possible vehicle for cost and energy savings due to increased accountability of utility costs for tenant agencies and the resulting effect on tenant behavior.

Evaluate and Consider a Net of Utilities Lease Structure When a Combination of the Following Factors Exists on a Case-by-Case basis:
✓ ***Lease size is large (>=50,000 RSF), and tenant agency represents the 100% building occupant***
✓ ***Space need is for a high-energy user (i.e., 24/7 operation), new lease construction, or unique use (e.g., warehouse, lab, special purpose)***
✓ ***Tenant agency has net of utilities infrastructure + administrative support processes in place***
✓ ***Tenant agency has the budgeting ability to account for fluctuations in energy costs + usage***
✓ ***Tenant agency pays utilities directly (versus GSA pays)***
✓ ***Tenant agency has strong leadership buy-in for net of utilities leases***
✓ ***Lease location is in a deregulated market where GSA can purchase energy at a bulk discount on behalf of tenant agency***

Note: Project teams and Lease Contracting Officers should use a fully serviced approach unless a combination of these conditions are in place. Large lease size and full building occupancy are the most critical pre-conditions when considering a net of utilities lease structure. Although having most of these factors present results in the higher likelihood of a viable net of utilities lease structure, each lease situation must be evaluated on a case-by-case basis.

Considerations

Benefits	***Challenges***
Tenant agency is incentivized to reduce energy consumption and costs, which may result in a reduction in total energy consumption and costs.	*Facilities Management, Contracting, Pricing, and Budgeting departments face an administrative and resource burden to implement net of utilities lease structure (when GSA pays utilities).There are up to 13 additional steps to administer and manage a net of utility versus a fully serviced lease (when GSA pays utilities).*
Some net of utilities successes have occurred with tenants whose agency has strong leadership buy-in for net of utilities leases, and who have adequate resources to administer them.	*Additional resources are needed to properly manage and monitor the net of utilities contracts including the award, reporting, auditing, and closeout processes.*

Benefits (continued)	***Challenges (continued)***
Net of utilities leases can allow tenant agencies to make progress towards Federal energy reduction and greenhouse gas reduction goals through reduced energy consumption.	*Managing the pass-through of actual utility costs is manually intensive (when GSA pays utilities), involving many reconciliations with risk of error and opportunities for financial loss. Collection issues, under-collecting, and limited reconciliations could occur throughout this process.*
	There is budget uncertainty for GSA and the tenant agency, related to unpredictable energy needs. Net of utilities leases requires 2-year advance planning to properly incorporate into GSA's and tenant agencies' budget requests, with buy-in from OMB.
	A Delegation is needed from GSA (Energy Division) for a tenant agency to procure utility services.
	Net of utilities lease structure reduces the incentive for lessors to maintain their building or implement energy efficient upgrades (when tenant or GSA pays utilities), with the risk of lessors being less engaged.