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The Cyclicality of Real Estate:

A critical Lesson for Government Infrastructure

Previously, A&M Federal Insights examined the evolving needs of military housing[1] and the billions in deferred maintenance haunting underutilized federal office spaces.[2] But beneath these glaring issues lies an often-overlooked natural rhythm: the cyclicality of real estate — an inescapable reality that government infrastructure planning has ignored for too long. The commercial real estate market has danced to the rhythm of boom-and-bust cycles, and federal properties should adapt similarly. Yet, instead of evolving to these cycles, the government often avoids the decisions that these market shifts demand. Grasping these cycles isn't just a nice-to-have; it's critical for transforming our federal infrastructure into a nimble, resilient asset.

The federal government has not adapted to the natural bust-and-boom cycles of the commercial real estate market.

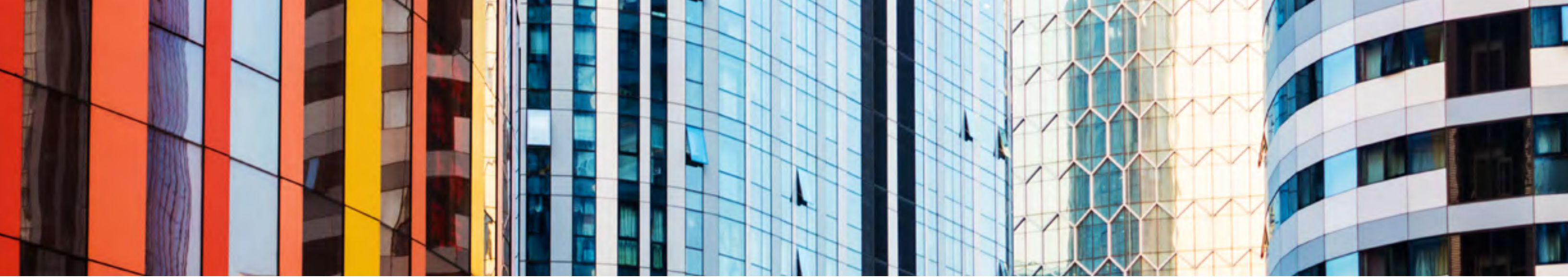
Historical Context: Real Estate Cycles in Theory and Practice

The classic real estate cycle is grounded in economic theory, following four phases: recovery, expansion, peak and recession. These phases reflect broader economic trends — markets stabilize after downturns, demand spikes lead to new projects, saturation results in overvaluation and, eventually, a recession sets in, with oversupply and underutilization marking the downturn.[3] Although the federal government is insulated from many externalities of economic shifts, its employees are not. Thus, while the commercial market runs in cycles, the government operates at a bit of a hybrid rhythm.

For decades, the federal government found itself in a near-permanent expansion phase, particularly concerning office space. From the post-war boom to the early 2000s, the government expanded its real estate portfolio to an enormous 3.2 billion square feet, often expanding properties as commercial markets began to cool. As the 2008 financial crisis led to significant corrections in the private sector, the government pursued similar initiatives with two policies: "Freeze the Footprint" in 2013[4] to offset new real estate with the liquidation of older buildings, and "Reduce the Footprint" in 2015[5] to reduce the federal real estate footprint.

During this period, private office space utilization declined at an annualized rate of 1.4 percent per employed individual until 2019 and 7.5 percent following the pandemic.[6]

The government now faces the need for not one, but two corrections to align its real estate portfolio with current needs. The costs are staggering — annual maintenance for federal real estate is approximately \$120–\$130 per square foot, not including the billions in deferred maintenance. Initial initiatives in 2013 and 2015 were a tremendous start, and now require greater scale and urgency to address the issue. As office utilization rates continue to fall and 11.4 million square feet of leases expire,[9] the government is afforded an incredible opportunity.



Future Investments and Strategic Steps

Jamie Dimon, the CEO of JPMorgan Chase, has a rather pragmatic view on recessions, defining them as "something that happens every five to seven years." It's a cyclical phenomenon, and with it comes the need to adapt. For too long, the federal government has operated out of sync with these natural market rhythms, resulting in a bloated real estate portfolio. Although the government may remain insulated as compared to its commercial peers, that doesn't mean it shouldn't adapt.

First, the government needs to fully evaluate its infrastructure portfolio globally, assessing the financial impact of the reduction to varying levels, future market conditions and future federal employee needs. This should set the groundwork to establish clear objectives, model scenarios, and define decision criteria to determine a way forward to divest leases and consolidate space. Remote and hybrid work models are here to stay, and any future investments or divestitures in office space must account for this shift. The government can not only reduce costs but also can ensure that its infrastructure is better aligned with the needs of the future. What's needed now is a bold, comprehensive approach to real estate management that recognizes and adapts to the inevitable cycles of the market.

With 11.4 million square feet of leases set to expire, the government has an incredible opportunity to realign it's real estate holdings to the market.

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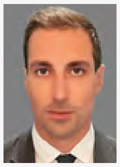

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