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Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

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July 12, 2004

The Honorable James Oberstar
Ranking Minority Member
Committee on Transportation
And Infrastructure
House of Representatives

The Honorable Eleanor Holmes Norton
Ranking Minority Member
Subcommittee on Public Buildings, Economic
Development and Emergency Management
Committee on Transportation
and Infrastructure
House of Representatives

Subject: General Services Administration and Real Estate Brokers' Commissions

This responds to your joint letter of March 23, 2004, requesting our opinion regarding some aspects of the General Services Administration's (GSA) proposed National Brokers Contract. In discussions with your staff, we agreed to address several questions centering on the nature of the services that GSA will obtain under the proposed National Brokers Contract and the payment for those services. We also agreed to explain the difference between GSA's proposed National Brokers Contract, which we addressed in a 2003 decision, B-291947, Aug. 7, 2003, and a Small Business Administration (SBA) contract related to its Preferred Lenders Program, which we addressed in a 2004 decision, B-300248, Jan. 15, 2004.

We are of the view that the broker services that GSA will acquire under the National Brokers Contract are services that brokers commonly offer in commercial leasing transactions. We found that for commercial leases, while it is common practice for the parties to negotiate the particular mix of services the broker will provide, the services that GSA will acquire are among those services that brokers commonly offer. We also found that while brokers may negotiate the method and amount of payment, which could be through a commission or fee, the services that GSA will acquire under the National Brokers Contract are commonly covered by landlords' commissions.

As we explain in more detail below, the legal nature of the proposed GSA brokers contract differs from that of SBA's contract. Under the proposed brokers contract, brokers will agree to provide services at no cost to GSA. B-291947, Aug. 7, 2003. As a

result, GSA has no financial liability to its brokers, and the brokers have no expectation of a payment from GSA. Such a contract is sometimes referred to as a “no cost” contract because the United States has no financial liability under the contract. SBA, on the other hand, did not have a “no cost” contract. SBA entered into a contract for assistance in reviews of lenders participating in its Preferred Lenders Program, and arranged to pay its contractor by improperly imposing fees on its lenders and requiring the lenders to pay those fees to the SBA contractor. B-300248, Jan. 15, 2004.

We have not analyzed the soundness or advisability of entering into the National Brokers Contract in this opinion, nor did we in our 2003 decision to GSA regarding GSA’s leasing program, B-291947, n.2, Aug. 7, 2003. However, in an enclosure to this opinion, we offer some questions that you may wish to consider in your oversight role.

In responding to your request, we asked GSA for its views in writing, interviewed GSA staff, surveyed professional literature relating to the provision of real estate services by brokers, and conducted some informal interviews with a number of persons familiar with the practices of the real estate profession. The persons we interviewed included some suggested by your staff as well as other academic and professional experts that we identified.¹

BACKGROUND

With its National Brokers Contract, GSA proposes to award approximately four real estate brokers exclusive rights to represent the United States with respect to all GSA real property leases. GSA Solicitation No: GS-04P-02-BVD-0035 (*hereinafter*, Solicitation), § M.² According to GSA, all four brokers must provide services nationwide. Letter from Samuel J. Morris, III, Associate General Counsel, GSA, to Thomas H. Armstrong, Assistant General Counsel, GAO, June 16, 2004, at 4 (GSA Letter). The solicitation identifies lease acquisition services that GSA expects from its contractors, ranging from helping federal agencies with the development of their space requirements to surveying the rental market to negotiating offers and preparing leases. Solicitation, § C.4.2.1. The solicitation, also, identifies lease expansion and extension services. *Id.* at §§ C.4.3, C.4.4. GSA officials will review all terms and

¹ The persons whom we consulted included present and former officers of professional real estate organizations, who are themselves brokers, and educators and published researchers from accredited public universities and professional institutes established to train brokers and study real estate practices.

² National Broker Services RFP, Volumes I - III, at <http://www2.eps.gov/spg/GSA/PBS/4PE/GS04P02bvd0035/ATTACHMENTS.html> (last visited on July 8, 2004).

conditions negotiated by contractors, and GSA contracting officers, not brokers, will execute leases that obligate the government. GSA Letter at 1.

In the past, GSA paid real estate brokers from GSA's appropriations. *See* B-291947, Aug. 7, 2003. GSA prohibited brokers from receiving compensation from any other source. *Id.* Recently, however, GSA decided to adopt a common practice of the real estate industry and allow the brokers to accept payment from landlords whose property the government leases. *Id.* The payment is in the form of a commission that is a percentage of the value of the lease. *Id.* GSA, of course, will ultimately pay the costs of brokers' commissions through its rent payments to its landlords. GSA Letter at 7.

The solicitation requires that each broker in its bid specify a percentage of its commission that it is willing to forego in government lease transactions. Solicitation, § B.2.1. The solicitation announces that in awarding broker contracts, GSA, in addition to evaluating brokers' technical ability to do the job, will consider the percentage of commission that the broker agrees to forego. *Id.* at § M. With respect to any lease transaction, GSA will require the broker to forego the percentage of the commission proposed in the broker's offer and the landlord to apply its savings in that regard as an offset to GSA's rent. *Id.*

DISCUSSION

You requested our opinion on several aspects of GSA's proposed National Brokers Contract.³ Because the National Brokers Contract will materially change how GSA implements the government's \$3.7 billion leasing program, you want to ensure that the contract is sound and in the best interests of the government. In your letter, you raise a number of concerns that relate primarily to GSA's characterization of the contract as reflecting the traditional arrangement between a tenant and its broker. *Id.* You believe that some of the services that GSA will acquire are services which brokers do not provide to tenants under "common industry practice" as addressed in our 2003 decision.

³ Letter from Representative James Oberstar, Ranking Minority Member, House Committee on Transportation and Infrastructure, and Representative Eleanor Holmes Norton, Ranking Minority Member, Subcommittee on Public Buildings, Economic Development and Emergency Management, House Committee on Transportation and Infrastructure, to David M. Walker, Comptroller General of the United States, Mar. 23, 2004.

Subsequently, in discussions with your staff, we agreed to address the following questions:

- 1) Under the contract, will GSA acquire services other than those that are commonly provided by private sector real estate brokers? Is GSA's characterization of the contract as "no-cost" meant to distinguish between traditional services (that is, those commonly provided) and non-traditional services? Will the broker provide all of these services gratuitously?
- 2) Noting that our August 2003 decision relied upon GSA's assertion that the National Brokers Contract would adopt the common industry practice whereby landlords pay broker's fees, you ask: if GSA uses the National Brokers Contract to gratuitously obtain non-traditional services from brokers, will that constitute an improper augmentation of GSA's appropriations?
- 3) In B-300248, January 15, 2004, we concluded that the Small Business Administration (SBA) could not compensate a contractor retained to assist with Preferred Lender Program oversight reviews by requiring the preferred lenders to pay a user fee directly to the contractor. How does SBA's contract differ from GSA's National Brokers Contract?

Because we found that GSA, in the National Brokers Contract, will procure only commonly provided services, we address questions 1 and 2 together.

Commonly Provided Services

The National Brokers Contract lists 10 services that brokers will be required to perform under the contract:

- 1) assisting the tenant agency with development of requirements;
- 2) participating in orientations with agency officials;
- 3) developing project schedules;
- 4) advertising agency requirements, and analyzing and surveying the market and preparing market survey reports;
- 5) if required by the contracting officer, preparing cost benefit analyses for the approval of the contracting officer as described in applicable GSA rules;
- 6) developing and issuing solicitations for offers;
- 7) reviewing and evaluating offers;
- 8) negotiating offers;
- 9) preparing lease contract documents and obtaining signatures; and
- 10) performing certain post award services.

Solicitation, § C.4.2.1.

GSA states that many brokerage firms have become “full service providers that manage a project from cradle to grave, including monitoring and administration of the build out of a tenant’s space.” GSA Letter at 2. Staff of GSA’s General Counsel’s Office informally told us that GSA will use the National Brokers Contract to procure only those services that GSA says real estate brokers commonly provide; that is, those services necessary to solicit offers for, and facilitate completion of, leases. The GSA staff told us that GSA will obtain any other services by using separate contractual vehicles, including GSA’s federal supply schedules.

GSA believes that the broker services it will acquire under the National Brokers Contract are services that brokers commonly provide tenants, and that it is not acquiring services for which brokers would expect to receive additional remuneration beyond that provided by the landlord’s commission. GSA Letter at 2. Prior to developing the scope of work for the contract, GSA conducted market research, including discussions with large corporations that have extensive leasing needs and with major real estate firms. *Id.* From these discussions, and its knowledge of industry custom and practice, GSA determined that the contract services are those that are commonly paid for by commissions from landlords to brokers, not by tenants. *Id.*

From both the professional literature and our informal consultations, we would agree. Our research indicates that while real estate brokers offer a wider range of services to their customers today (the so-called “cradle-to-grave” services) than they may have in the past, and that the actual services that a broker may perform for a customer, and the payment for those services, is subject to negotiation between the broker and its customer, the services listed in the National Brokers Contract are services that brokers commonly provide to close a lease transaction and are services typically expected to be covered by landlords’ commissions to brokers.

The literature that we reviewed makes a distinction between transactional services, which are typically expected to be covered by landlords’ commissions to brokers, and consultative services, which are additional services for which brokers charge tenants a fee. In the 1990s, brokerages began “to shift away from the traditional deal-by-deal way of doing business”⁴ to “a hybrid that involves reduced commissions plus fees for . . . ancillary services” based on “value delivered outside of the pure property deal.”⁵ One commentator pointed to landlord-paid commissions as a reason for the shift: “While commissions have always proven negotiable to some extent, brokers today

⁴ Steve Brown, “Commercial Real Estate Brokers: Firms Tightening Belts in Changing Markets; New Services and Directions Can Bring Success,” *National Real Estate Investor* at 81, 82 (March 1990) (*hereinafter*, Brown).

⁵ Michael Fickes, “A changing pie,” *National Real Estate Investor* at 52, 53 - 54 (July 2000) (*hereinafter*, Fickes).

report wild plunges in what owners are willing to pay.” Fickes at 52. To supplement commissions, brokers began offering other services, what GSA calls “cradle-to-grave” services, for which they charge fees. These include, for example, assistance in putting together a financing plan, fitting out new property or renovating old property, and property management and related services. *Id.* at 54; Brown at 82. One commentator describing this new direction said, “It’s the consultative approach to delivering services vs. the traditional transactional approach.” Brown at 82. According to a recent article in *The New York Times*, “While most such companies still make the bulk of their profits from brokerage fees, they now offer a broad array of other services including property and leasing management, research, appraisals, investment management, mortgage lending, strategic planning and sometimes project management and development.” Terry Pristin, “The Market Is Rising for Real Estate Services. How About Shares?” *The New York Times* at C6, Mar. 17, 2004. From the literature’s description of the various services that brokers might offer, the services that GSA will acquire under the National Brokers Contract, in our view, are transactional services that are commonly covered by landlords’ commissions.

Our interviews with persons who are familiar with real estate practices confirm this view. The persons whom we interviewed stated that all ten of the services listed in the proposed National Brokers Contract are services that brokers commonly provide, although a broker may not necessarily perform all ten services in every transaction. They also said that while brokers will often accept a landlord’s commission in full payment for these services, sometimes a broker may not; they opined that many brokers, for example, might negotiate to have the tenant pay separately for post-award services.

Of course, in performing for GSA, brokers will have to tailor the details of how they provide their services to fit the various specific statutory and regulatory requirements applicable to government leases of real property. In informal conversations, GSA staff explained, and we would agree, that this differs only in the details that any broker faces; brokers necessarily tailor their services to the circumstances and needs of individual clients. *See also* GSA Letter at 2.

Also, GSA recognizes that while a broker will assist in such activities as reviewing and evaluating offers, negotiating terms and conditions of leases, and preparing lease documents, GSA officials must review all broker actions, and only GSA contracting officers may execute leases that will obligate the government. GSA Letter at 1.

Comparison of GSA Contract with SBA Contract

You asked us to explain our 2003 GSA decision in light of a subsequent opinion addressing an SBA contract, B-300248, Jan. 15, 2004. In our 2003 GSA decision, we concluded that GSA’s proposed brokers contract would not be an unauthorized augmentation and would not violate the statutory prohibition on accepting voluntary services, 31 U.S.C. § 1342. In our 2004 SBA opinion, we concluded that SBA had constructively augmented its appropriation when it improperly imposed fees on its

Preferred Lenders Program lenders and required the lenders to pay those fees to an SBA contractor to defray the cost to SBA of the contractor's services. SBA had no authority to impose those fees. SBA transferred its liability to a third party and augmented its appropriations.

The proposed National Brokers Contract is what is sometimes referred to as a "no cost" contract; that is, the contractor provides services under a formal contract at no cost to the United States. *See* B-291947, Aug. 7, 2003. In our 2003 decision, we concluded that because of the "no cost" nature of the contract, it would not constitute an unauthorized augmentation and would not violate the statutory prohibition on accepting voluntary services. *Id.* Because the contract was constructed as a no cost contract, GSA will have no financial liability to brokers, and brokers will have no expectation of a payment from GSA. The acceptance of services without payment pursuant to a valid, binding no-cost contract does not augment an agency's appropriation nor does it violate the voluntary services prohibition. Although the brokers contract clearly expects that brokers will be remunerated by commissions from landlords, as is a common practice in the real estate industry, GSA does not require landlords to pay commissions. If a landlord were to fail to pay a broker, the broker would have no claim against GSA.

SBA, unlike GSA, did not have a no-cost contract. In the SBA case, SBA retained a contractor to assist it with oversight reviews of SBA's preferred lenders. We concluded that SBA constructively augmented its appropriations when it arranged for payment of its contractor's services by improperly imposing a fee on its preferred lenders and requiring them to pay the fee directly to SBA's contractor. B-300248, Jan. 15, 2004. Prior to the start of each fiscal year, SBA and its contractor, together, agreed on the amount of the fee to ensure that the fee would cover all of the contractor's costs, including the contractor's employees' salaries, and travel and administrative expenses. *Id.* The fee, which SBA imposed and which SBA directed be paid to the contractor, was intended to defray SBA's liability to the contractor. If a preferred lender failed to pay the SBA contractor, the contractor would have a claim against SBA for payment.

The important difference between the GSA and SBA contracts is that under GSA's contract with brokers, brokers offer their services without any expectation of payment from GSA, whereas under SBA's contract, the contractor offered its services only after SBA agreed to impose a fee on its preferred lenders to cover the contractor's costs and to require the lenders to pay that fee to the contractor.

CONCLUSION

In our view, while the particular services a broker may perform for a particular customer, and the payment for those services, are subject to negotiation between the broker and its customer, the services that GSA will acquire under the National Brokers Contract are services that brokers commonly offer in commercial leasing transactions and are commonly covered by landlords' commissions.

GSA's National Brokers Contract, unlike SBA's contract for assistance in preferred lender reviews, would not constitute a constructive augmentation of GSA's appropriations. Under the National Brokers Contract, brokers clearly have no expectation of payment from GSA, and if a landlord were to fail to pay a commission to a broker, the broker would have no claim for a payment against GSA.

If you have any questions regarding this matter, please contact Susan A. Poling, Managing Associate General Counsel, or Thomas H. Armstrong, Assistant General Counsel, at 202-512-5644.

Sincerely yours,

/signed/
Anthony H. Gamboa
General Counsel

Enclosure

Enclosure

Oversight Considerations

In this opinion, we have not analyzed the soundness of the terms of the National Brokers Contract or the advisability of entering into the contract. However, we do offer the following questions that you may wish to consider in your oversight role:

- Has GSA, by requiring brokers to earn commissions from landlords rather than payments from GSA, provided brokers an incentive to steer government leasing to properties whose owners pay commissions, and to those owners who pay the larger commissions, at the expense of owners who pay no commissions to tenant brokers?
- Because GSA will no longer pay brokers, thereby reducing its costs of providing space to federal agencies, will GSA reduce the amounts that it charges agencies for the services that GSA provides them?
- Given the size of the government's leasing program and the peculiar space needs of federal agencies, will GSA engage an adequate number of competent brokers under the National Brokers Contract?

As brokers revise their businesses to rely less on landlord-paid commissions, will GSA be able to acquire broker services for the government leasing program?