

## VIEWPOINT ARTICLE

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**The American Recovery and Reinvestment Act of 2009:**  
Implications for Commercial Real Estate and Facilities  
Management

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## EXECUTIVE SUMMARY

The American Recovery and Reinvestment Act (ARRA) is a significant piece of legislation that will have considerable impact on businesses involved in property and facility management. This whitepaper brings to light many of the implications and opportunities associated with the ARRA and explores specific scenarios created by this new initiative. Strategic decisions that are affected by the legislation as well as the potential new growth areas that it has created are examined in detail. In particular, the possibilities offered by green technologies, real estate leasing strategies and asset renewal strategies are discussed, in addition to the questions that surround the Act's "Buy American" provisions.

Indeed, the uncertainty surrounding the ARRA clouds an objective understanding of several important property management topics: How will the Buy American clause play out? Will the overall spending be enough? Is spending being done in the right areas? The answers to these questions are still quite unclear. It would seem that the ARRA is a step in the right direction with regards to jumpstarting the US economy. However, it remains to be seen whether the measures described in the Act will be enough to help the commercial real estate and facility management industry as a whole, or whether only certain sectors of the industry will see any benefit. This document attempts to explain and clarify as much as possible the effect that the ARRA will have on the future of property and facilities management.

*“Strategic decisions that are affected by the legislation as well as the potential new growth areas that it has created are examined in detail.”*

## DISCUSSION

### The American Recovery and Reinvestment Act of 2009

#### Key Points

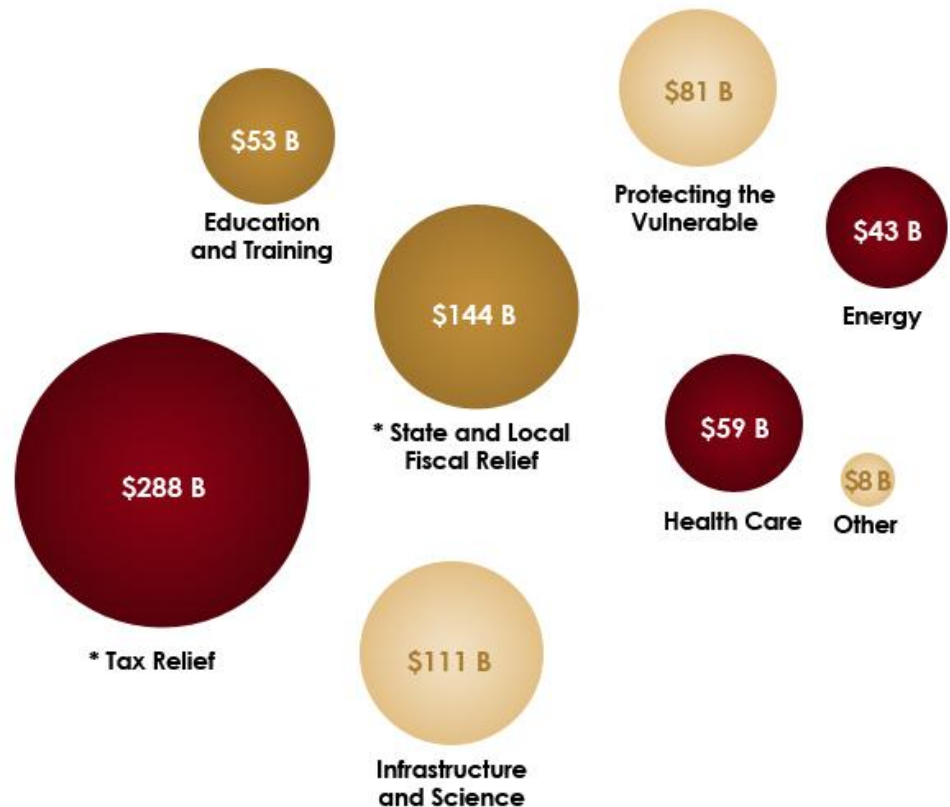
- ▶ Total value of \$787-billion; the single largest spending and tax bill in US history.
- ▶ Focuses on infrastructure development, poverty reduction, health care, and education.
- ▶ Visit [www.recovery.gov](http://www.recovery.gov) for updated information on fund

On February 17th, 2009, the US Congress passed the American Recovery and Reinvestment Act (ARRA) into law. The ARRA or "Stimulus Package" is the Obama Administration's solution to invigorating the slumping economy in the United States. The main goals of the ARRA are to save and create over 3.5 million jobs, reduce healthcare costs, develop infrastructure and jumpstart the renewable energy industry. The value of the package is \$787 billion, which represents the single largest spending and tax bill in US history. This high level of funding has enticed both individuals and businesses alike to ask how they can capitalize on the ARRA. While the measures government officials have taken in the ARRA to stem the increase in residential real estate foreclosures are noteworthy, the plan has been criticized for a perceived failure to inject enough funding into commercial real estate. Many industry experts have also noted that the bill is lacking clarity when it comes to several issues.

The ARRA website ([www.recovery.gov](http://www.recovery.gov)) updates daily with fund allocation information, which allows for the tracking of government spending by state, by recipient, or by business category as it is allocated to the private sector.

*"This high level of funding has enticed both individuals and businesses alike to ask how they can capitalize on the ARRA."*

To gain a better understanding of the distribution of the general ARRA funding, an illustration is provided below:



Source: [www.recovery.gov/?q=content/investments](http://www.recovery.gov/?q=content/investments)

## Implications & Opportunities for the Real Estate & FM Organizations of Fortune 500 Companies

### Key Points

- ▶ \$43 billion injected into green energy initiatives, much of which will be directed towards private sector-driven capital projects.
- ▶ The ARRA extends the 50% bonus depreciation on long term assets until the end of 2009.
- ▶ Businesses should be wary of the Buy American provisions and its implications for global companies.

## The Push Towards Increased Energy Efficiency

The ARRA will inject approximately \$43 billion into green energy initiatives<sup>1</sup>. This funding covers a wide range of initiatives, including home energy efficiency upgrades, government building improvements, and an extension of existing renewable energy tax credits.

Although the ARRA is a step forward, some feel that the stringent requirements needed to take advantage of these 'green incentives' will deter many companies from pursuing energy efficiency improvements. For example, in order for a corporation to take advantage of HVAC specific tax credits, the Seasonal Energy Efficiency Ratio<sup>2</sup> (SEER) on the related piece of equipment must be above 10. Robert McDonough, President of Carrier Corporation which is one of the largest HVAC service providers, believes that this requirement is simply too high and only appeals to a narrow band of companies who have already made significant inroads towards becoming more energy efficient<sup>3</sup>.

Many other companies, however, feel that these new incentives have actually tipped the cost-benefit balance in favor of large, capital-intensive projects that may save them money in the end. The green transformation of the Sears Tower in Chicago is a perfect example of how new tax incentives, mixed with higher energy prices worldwide have had an impact on a company's willingness to invest in environmentally-friendly initiatives. The Sears Tower, now known as the Willis Tower, will be undergoing a \$350-million energy retrofit that is expected to save its owners 80% on future energy costs<sup>4</sup>.

Companies interested in pursuing these types of initiatives should consider speaking with a tax consultant and performing a review of their cost benefit analysis pertaining to green capital projects.

*“The ARRA will inject approximately \$43 billion into green energy initiatives.”*

### **'Green Collar' Work**

The shift in the cost-benefit balance towards green investments will inevitably lead many companies to invest in new technologies. Higher demand for these technologies will bring about a surge in 'green collar' work due to the additional maintenance expertise that will be needed. There are several ways companies can approach this situation. Choosing to outsource the work can lead to the assumption of additional costs, due to the shortage of trained workers. An alternative to this approach would be to perform in-house training of existing employees, although this, too, could prove to be cost prohibitive. In either case, real estate companies must weigh the benefits of outsourcing against its costs and decide whether outsourcing green technology maintenance is something they wish to pursue. For organizations who currently do not outsource their facility management service, this new expertise requirement could be enough to jumpstart interest in that particular approach.

Fortunately for the private sector, there will be over \$5.5 billion spent on transforming federal buildings into high-performance green buildings. For the most part, these funds will go to private contractors who will hire and train a supply of qualified 'green collar' workers. The number of 'green collar' workers will continue to grow in order to meet private sector demands<sup>5</sup>.

Economic development corporations now have a new responsibility to ensure that trade schools are offering programs that can provide communities with graduates who are armed with the skills required to work in green collar jobs.

### **Bonus Depreciation**

The ARRA extends the 50 percent special depreciation on capital expenditures offered to businesses. This enables businesses to deduct half of the adjusted basis of qualifying property<sup>6</sup>. Therefore, equipment purchases may now be more affordable than they were in the absence of the ARRA. In many cases, to take advantage of this special depreciation businesses will need

*“The shift in the cost-benefit balance towards green investments will inevitably lead many companies to invest in new technologies.”*

to make changes to their capital renewal processes. Considering this, facility management companies are in a prime position to advise businesses about what has changed.

### **Buy American**

The Buy American provision is arguably the most controversial aspect of the ARRA. It essentially states that any work done on a public building or public work must be done using manufactured goods which have been produced in the United States. Despite this requirement, the ARRA does not specifically define the terms “public building”, “public work”, “manufactured goods”, or “produced in the United States”<sup>7</sup>. The ambiguity of the language, whether intentional or not makes it difficult to predict how the provision will influence business processes in the United States.

The ARRA has since been amended to indicate that it does not overrule existing international trade agreements<sup>8</sup>. However, it remains to be seen exactly how the ARRA will affect global trade, which may prove to be paramount to companies who rely heavily on this type of commerce. Many Fortune 500 companies like Caterpillar and GE have protested this aspect of the ARRA bill. It would be prudent for businesses to prepare contingency plans to deal with the possibility that the Buy American clause may adversely affect their operations.

### **Leases**

While the stimulus bill has been helpful in counteracting the residential real estate crisis, its response to the commercial crisis has been criticized. According to FMI's construction index, 88% of non-residential building contractors have not yet felt any positive effects related to the stimulus bill<sup>9</sup>. Ross Moore, Executive VP for major commercial real estate service provider Colliers International, does not expect the ARRA to have any effect on the commercial real estate industry in the short term. He believes that select office (mainly Washington, DC) and industrial markets will feel the benefit late in 2009 and then increasingly in 2010<sup>10</sup>.

*“The Buy American provision is arguably the most controversial aspect of the ARRA.”*



The ARRA also addresses sale-leasebacks, which have been gaining popularity in recent years. Once again, however, the vague language used in the ARRA has veiled the true effects of the anti-churning laws. While it remains to be seen how the IRS will enforce these rules, accountants have stated that it seems likely that if any “creative” method of exploiting this provision is published, the IRS would have clear authority to invoke its authority<sup>11</sup>.

Over the past several months, much of the commercial real estate activity across markets has been in the form of lease renewals. The recession has led to an increase in office space vacancies, which has provided tenants with new tools of negotiation<sup>12</sup>. Many tenants are using their favorable position in the marketplace to restructure their leases. In face of the growing optimism that the ARRA will put upward pressure on the economy to bounce back, it follows that now may be the time for companies who have not already done so to re-evaluate their current leases and possibly renegotiate before the balance shifts back in the landlord's favor.

### **Implications & opportunities for corporate real estate companies, FM service companies & EDCs**

#### **Key Points**

- ▶ The ARRA will have little or no direct impact on the commercial real estate market.
- ▶ In combination with the \$75 billion Homeowner Affordability and Stability Plan, the ARRA should have an indirect impact via a trickledown effect.
- ▶ The ARRA is likely to revolutionize private and public sector relations through changes in business processes such as shorter turnaround demand for proposals and more rigorous activity-based auditing.
- ▶ The shift to green is here, and the ARRA provides the stimulus necessary to push the industry to the tipping point.
- ▶ FM companies who currently do not offer green services should consider joint ventures with smaller renewable energy companies in order to benefit from their expertise.

*“Many tenants are using their favorable position in the marketplace to restructure their leases.”*

- ▶ The ARRA will inject \$7 billion into to broadband and wireless internet network development.

### **The Commercial Real Estate Market**

The ARRA does not directly address the impact that the recession has had on the commercial real estate sector. This is of particular concern given the fact that just recently, two of the largest investors in US office space claimed that a commercial real estate crash will be the next front in the financial crisis<sup>13</sup>.

Many feel, however, that the ARRA, in combination with the \$75-billion Homeowner Affordability and Stability Plan unveiled only a day after the ARRA, may have an indirect impact on the commercial market. John Terrence Farris, Director of the Real Estate Development Program at Clemson University suggests that the federal funds will have a trickledown effect that will ultimately benefit the commercial market. He predicts a boom in commercial real estate, but only after the residential market stabilizes<sup>14</sup>. Either way, the ARRA will be a driving force behind major changes in the way business is carried out.

### **Changes to Business Processes**

The President of TRIRIGA Inc, a real estate and FM company, has inferred that the ARRA will revolutionize the way companies report on their environmental projects, and that the bidding process is also in the midst of changing. Therefore, businesses should expect shorter turnaround times for proposal development, as well as an increase in the proportion of fixed-price contracts that they sign<sup>15</sup>. As a corollary, companies that often work on government projects will need to be more cost-conscious, as contracts will be more often of a fixed nature. It follows, then, that facilities management companies servicing the government sector will have to be diligent in ensuring that their business is running as efficiently as possible. The government will also enforce more rigorous reporting and disclosure as it relates to ARRA projects.

*“The ARRA does not directly address the impact that the recession has had on the commercial real estate sector.”*

### The Green Shift

The shift to green is here and the ARRA is providing the stimulus necessary to push the industry to the tipping point. It is finally becoming more cost-effective to go green. No longer is the term simply a piece of a corporation's social responsibility strategy - rather, companies now realize how being green can lead to long-term cost savings. For this reason, companies in general will begin to demand greener services. In fact, the effects have already been realized. A 2008 report published by the Burnham-Moores Center for Real Estate at the University of San Diego indicates that tenants are willing to pay a premium to rent in green buildings - up to an extra \$2.45 per square foot for commercial tenants renting green office space. The centre's director believes that the added value to the real estate sector now exceeds the extra costs associated with going green<sup>16</sup>.

It is clear that real estate companies should now consider making green investments. FM companies need to give serious thought to enhancing their green service offerings. FM companies that currently do not have green energy as part of their service offering must take steps to change that.

### Joint Ventures

In the short term, the ARRA will be the driving force behind several joint ventures within the energy sector. The fragmented nature of the renewable energy industry may drive small energy companies to collaborate with FM companies in order to gain access to a strong client base. Evolution Solar Corporation, for example, has announced that it has identified several US partners that it plans to collaborate with on alternative energy projects as part of the ARRA. By throwing in with larger companies the Evolution Solar believes its project bids will be more competitive<sup>17</sup>.

FM and real estate corporations alike who are looking for a way to provide green solutions as part of their service offerings should consider joint ventures with smaller businesses that complement their skill set.

*“It is finally becoming more cost-effective to go green.”*

## Economic Development

The ARRA bill provides a significant amount of funding to support infrastructure projects. In London, UK, where it has become clear there that economic development is dependent on public-private partnerships, a similar phenomenon has occurred. Without these partnerships, individuals, businesses and developers choose to avoid these areas as they do not have what is perceived to be the necessary government support<sup>18</sup>. With the influx of infrastructure spending, economic development corporations can expect to be busy. Significant spending in the coming months will undoubtedly lead to opportunities that economic development corporations should be ready to take on.

On a similar thread, the ARRA act introduces a new government program: the Broadband Technology Opportunities Program. This program is designed to invest over \$7 billion on broadband and wireless Internet access<sup>19</sup>. Again, this can only support economic development corporations looking to spur growth in areas without broadband access. More information on the government's broadband initiative can be found online at [www.broadbandusa.gov](http://www.broadbandusa.gov).

### Case Study: Johnson Controls and their ARRA experience

In February 2009, the Business Journal of Milwaukee reported that the stimulus package provided major opportunities for Johnson Controls (JCI) buildings segment<sup>20</sup>. JCI is a market leader in producing energy efficient technologies for buildings. Almost six months later, their initial projections have held true. According to JCI, it has \$750 million of ARRA related projects in their pipeline. Additionally, the company believes its total market opportunity for ARRA projects to be close to \$12 billion. This is an encouraging sign for both JCI and its competitors.

Although JCI has an overall positive outlook, it has seen a 7% decrease to their building segment sales and a 35% decrease in segment income between 2008 and 2009<sup>21</sup>. JCI is not alone. The global commercial construction backlog has faced double digit declines<sup>22</sup>. Interestingly, the ARRA is partly to blame for this. Many real estate companies have halted energy efficient projects in order to wait and monitor for possible new ARRA funding for their projects. This has had a negative effect on the industry, but this trend is expected to turn around as businesses start to have their ARRA requests confirmed.

*“With the influx of infrastructure spending, economic development corporations can expect to be busy.”*

## CONCLUSION

The US Government has put forth a valid approach to stimulating the economy with the ARRA. While the legislation is largely focused on areas exterior to commercial real estate and facilities management, there are legitimate opportunities for companies in those sectors. Funds are available for both making buildings greener, and for undertaking capital projects (through tax breaks).

Nevertheless, the ARRA means more to these industries than simply the funds available. There are widespread questions that remain unanswered. What is the Buy American stipulation really going to mean for the industry? How long will it take commercial real estate to rebound? How much 'green' work will the ARRA actually inspire? These implications are crucial for companies to consider. The tax breaks and green energy funds will mean a major change in the cost-benefit analysis for projects. It also means that FM companies will need to ensure that their service offering includes green options.

The most responsible course of action for FM companies is to adopt a serious survey of their current business model and identify the areas which could be either adversely or positively affected by the ARRA package. Being prepared is far preferable to taking a more reactive stance through the next few months, which seem poised to deliver a sea change with regards to specific sectors of the industry.

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<sup>1</sup> Anonymous, "U.S. renewable energy gets \$43 billion from stimulus," International Business Times, 18 Feb. 2009  
[http://www.ibtimes.com/articles/20090218/uto-invest-43-billion-renewable-energy\\_1.htm](http://www.ibtimes.com/articles/20090218/uto-invest-43-billion-renewable-energy_1.htm)

<sup>2</sup> **Seasonal Energy Efficiency Rating:** The most commonly used measure of the efficiency of central air conditioning systems. As of January, 2006, an air conditioner must have a SEER of at least 13 to be sold in the United States. Higher efficiency models have a SEER of up to 21.  
<http://www.furnacecompare.com/faq/definitions/seer.html>

<sup>3</sup> Joanne Turpin, "CEOs provide straight talk at ACCA Forum," Air Conditioning, Heating and Refrigerating News, March 23 2009, 236:12:1,3.

<sup>4</sup> U.S. Equities Asset Management LLC, "Transforming an Icon," WillisTower.com July 20 2009 <http://www.willistower.com/icon>

<sup>5</sup> Matt Hudgins, "Stimulus Bill's Sustainability Elements Disappoint Commercial Landlords," National Real Estate Investor, Feb. 2, 2009  
<[http://nreionline.com/brokernews/greenbuildingnews/news/stimulus\\_bill\\_disappoint\\_commercial\\_landlords\\_0202/](http://nreionline.com/brokernews/greenbuildingnews/news/stimulus_bill_disappoint_commercial_landlords_0202/)>.

<sup>6</sup> "Property that qualifies," Section179.org,  
<[http://www.section179.org/property\\_that\\_qualifies\\_for\\_section\\_179.html](http://www.section179.org/property_that_qualifies_for_section_179.html)>

**Property that Qualifies for "Bonus Depreciation":** Equipment (machines, etc) purchased for business use, tangible personal property used in business, Business Vehicles with a gross vehicle weight in excess of 6,000 lbs , Computers, Computer Software (off the shelf), Office Furniture, Office Equipment, Property attached to your building that is not a structural component of the building (i.e.: a printing press, large manufacturing tools and equipment), Partial Business Use (equipment that is purchased for business use and personal use - generally, your deduction will be based on the percentage of time you use the equipment for business purposes.)

<sup>7</sup> United States Congress, "Section 1605: Buy American," American Recovery and Reinvestment Act of 2009 p. 189  
< [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111\\_cong\\_bills&docid=f:h1enr.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h1enr.pdf)>

<sup>8</sup> Ibid

<sup>9</sup> Anonymous, "**FMI; Stimulus Slow to Help Non-residential Construction, yet Index is up 26 Percent,**" Real Estate Business Journal, June 13 2009, p.43.

<sup>10</sup> Bill Trub, "The Real State of Commercial Real Estate," Business Facilities, April 2009 <[http://www.businessfacilities.com/bf\\_09\\_04\\_feature2.php](http://www.businessfacilities.com/bf_09_04_feature2.php)>

<sup>11</sup> Ed Zollars, "Losses and Choices-Stimulus Bill Net Operating Loss Rules," Tax Update, February 16 2009 < [http://www.edzollars.com/2009-02-16\\_NOL.pdf](http://www.edzollars.com/2009-02-16_NOL.pdf)>

<sup>12</sup> Trub



<sup>13</sup> Fransceso Guerrero & Greg Farrell, "US banks warn on commercial property," Financial Times, July 22 2009  
<[http://www.ft.com/cms/s/0/3a1e9d86-76eb-11de-b23c-00144feabdc0.html?nclick\\_check=1](http://www.ft.com/cms/s/0/3a1e9d86-76eb-11de-b23c-00144feabdc0.html?nclick_check=1)>

<sup>14</sup> Denise Kalette, "Stimulus Could Benefit Commercial Real Estate," National Real Estate Investor, Feb. 19, 2009  
<http://lhonline.com/news/stimulus-commercial-real-estate-0219/>

<sup>15</sup> George Ahn (President of Tririga, Inc.), "The Greenest Building is the One You Don't Build," Environmental Leader, April 7 2009  
<http://www.environmentalleader.com/2009/04/07/the-greenest-building-is-the-one-you-don-t-build/>

<sup>16</sup> "Green buildings bring higher rental rates, Burnham-Moores Center study finds", Daily Construction News (by Reed Construction Data), Feb. 15 2008  
<http://www.dcnonl.com/article/id26427>

<sup>17</sup> Anonymous, "Evolution Solar Corporation; Stimulus Program Opens Doors for Evolution Solar," Energy Business Journal, May 15 2008, pg. 138

<sup>18</sup> Anonymous, "DEBATE: In a recession is it fair to expect planning again?," Building Design, Mar. 20 2009, pg. 9

<sup>19</sup> United States Congress (ARRA document), p. 398-407

<sup>20</sup> Rovito, Rich, "Johnson Controls could reap millions from stimulus package," The Business Journal of Milwaukee, Feb. 27 2009  
<http://milwaukee.bizjournals.com/milwaukee/stories/2009/03/02/story12.html>

<sup>21</sup> "Johnson Controls: Quarterly Update FY 2009 third quarter July 20, 2009," Johnson Controls, Inc. (presentation), p.8

<sup>22</sup> "Jonhson Controls: Ingenuity Welcome – JP Morgan HVAC Conference," Johnson Controls, Inc. (presentation), p.16