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Decision

Matter of: Second Street Holdings, LLC

File: B-417006

Date: January 17, 2019

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DIGEST

Solicitation requirement for offerors to propose two fixed-price, assignable purchase options for leased properties exercisable after 15 or 25 years, respectively, is not unreasonable, unduly restrictive of competition, or impermissibly vague.

DECISION

Second Street Holdings, LLC, 600 Second Street Holdings, LLC, Seven Hundred 2nd Street Holdings, LLC, and their managing agency Property Group Partners collectively protest the terms of request for lease proposals (RLP) 5DC0392 issued by the General Services Administration (GSA), Public Buildings Service, for the long-term lease of a property or properties to serve as the headquarters for the Securities and Exchange Commission (SEC).¹ The protesters contend that the RLP is unreasonable, unduly restrictive of competition, unduly vague, and unfairly prejudicial to them because it requires an offeror to propose two fixed-price, assignable purchase options that the agency may choose to exercise 15 or 25 years in the future, respectively.

We deny the protest.

¹ The protesters have jointly submitted an offer in response to the RLP.

BACKGROUND

Currently, the SEC leases space for its headquarters in three buildings: 100 F Street NE, Washington, D.C., 600 Second Street NE, Washington D.C., and 700 Second Street NE, Washington, D.C. Agency Report (AR), exh. 1, Memorandum of Law (MOL), at 3. The three buildings collectively house the SEC's headquarters and are owned by the protesters. Id. The three existing leases will expire between April of 2019 and February of 2021. Id. In December of 2016, the GSA submitted a prospectus to its Congressional oversight committees describing a proposed long-term lease of space for the SEC headquarters in accordance with 40 U.S.C. § 3307. MOL at 3 and AR, exh. 3, Prospectus PDC-11-WA17. The relevant committees of the Senate and House of Representatives indicated their assent to the prospectus on November 29, 2017 and April 12, 2018 respectively. See AR, exhs. 5, 10, Senate and House of Representatives committee resolutions.

On July 10, 2018, GSA issued the RLP seeking to lease up to 1,274,000 square feet of office and related space for an initial term of 15 years, with a fixed-price option to renew the lease for 10 additional years for a total of 25 years. MOL at 3. Additionally, the RLP required offerors to include two fixed-price, assignable purchase options for the leased property, one of which would be exercisable at the end of the initial 15-year lease term, and one of which would be exercisable at the end of the 10-year renewal term. Id.; RLP at 21. The RLP included a draft lease specifying that any leases of parts of the facilities to non-government parties should be cancellable as of the dates on which a transfer of ownership would occur, but that the government may negotiate a purchase price adjustment for any non-government leases with termination dates that extend beyond the transfer date. AR, exh. 25, RLP Draft Lease, at 47

The RLP established that award would be made on a lowest-price, technically acceptable (LPTA) basis, with the price for each proposal being calculated using a net present value (NPV) formula. AR, exh. 24, RLP at 23-25. Relevant to this protest, the RLP indicated that the NPV of the purchase options would be included in the evaluated price, and would be computed by taking 50 percent of the offered price, and then discounting that fraction at a 5 percent annual rate. Id. at 25. The RLP also provided that if the facility were larger than the space required for the government's use under the lease, the purchase option would only be included in the evaluated price pro rata based on the American National Standards Institute/Building Owners and Managers Association Office Area (ABOA) square footage occupied by the government. Id.

On August 31, 2018, the protesters filed an agency-level protest of the RLP, and that protest was denied on October 4, 2018. AR, exh. 27 at 13. This protest followed.

DISCUSSION

As a preliminary matter, the protesters contend that they do not contest the agency's inclusion of purchase options in the RLP per se,² but rather object to certain features of the purchase options.³ Comments at 1-2. Specifically, the protesters object to the fixed-price nature and assignability of the purchase options. Comments at 2, 16. The protesters contend that these option requirements are unreasonable because they are inconsistent with industry practice and unrelated to a legitimate agency need. Comments at 4-10. The protesters additionally argue that the requirements are both unduly restrictive of competition and impermissibly vague such that offerors are unable to compete on a common basis. Comments at 20. Finally, the protesters allege that the requirements and evaluation methodology unfairly prejudice the protesters specifically.⁴ See, e.g., Comments at 17-19.

The determination of the government's needs and the best method of accommodating them is primarily the responsibility of the procuring agency. Columbia Imaging, Inc., B-286772.2, B-287363, Apr. 13, 2001, 2001 CPD ¶ 78 at 2. Our Office will not sustain a protest challenging an agency's determination of its needs unless the protester presents clear and convincing evidence that the specifications are in fact impossible to meet or unduly restrict competition. Instrument Control Services, Inc.; Science Management Resources, Inc., B-289660, B-289660.2, Apr. 15, 2002, 2002 CPD ¶ 66 at 6. To the

² The protesters argue, for example, that they would have no objection to a purchase option that required the parties to negotiate the fair market value at the time of exercise. Protest at 10.

³ We note that some of the protesters' arguments appear to contradict this assertion, such as their argument that the inclusion of a purchase option violated the agency's internal guidance for interpreting Congressional approvals of a lease prospectus. See Comments at 19-20. Setting aside the protesters' inconsistent representations, we do not reach this argument because compliance with internal agency guidance is not a matter subject to our review through the bid protest process. B&B Medical Services, Inc., B-407113.3, B-407113.4, June 24, 2013, 2013 CPD ¶ 162 at 6 n.6.

⁴ The protesters raise numerous collateral arguments in their protest that we do not address here. For example, the protesters argue that the agency erred in using ABOA square footage as the basis of its price analysis because that measure of square footage is not customarily used in commercial real estate transactions and is otherwise unreasonable. Protest at 17; Comments at 14. However, in their protest and subsequent pleadings, the protesters have not made clear what salient features of that measurement make it an inappropriate measure of space in this case, or, indeed, how it differs from the alternative manner of measurement that the protesters would prefer. Id. Accordingly, the protesters have failed to set out the factual grounds necessary to establish a legally sufficient basis of protest with respect to that argument. 4 C.F.R. § 21.1(f). We have reviewed all of the protest grounds raised by the protesters and conclude that none provides a basis to sustain the protest.

extent a protester challenges a specification as unduly restrictive, that is, challenges both the restrictive nature of the requirement as well as the agency's need for the restriction, the procuring agency has the responsibility of establishing that the specification is reasonably necessary to meet its needs. Smith and Nephew, Inc., B-410453, Jan. 2, 2015, 2015 CPD ¶ 90 at 5. The adequacy of the agency's justification is ascertained through examining whether the agency's explanation is reasonable, that is, whether it can withstand logical scrutiny. Id.

Additionally, as a general rule, a solicitation must be drafted in a fashion that enables offerors to intelligently prepare their proposals and must be sufficiently free from ambiguity so that offerors may compete on a common basis. Raymond Express Int'l, B-409872.2, Nov. 6, 2014, 2014 CPD ¶ 317 at 9. However, there is no requirement that a competition be based on specifications drafted in such detail as to completely eliminate all risk or remove every uncertainty from the mind of every prospective offeror; to the contrary, an agency may provide for a competition that imposes maximum risks on the contractor and minimum burdens on the agency, provided the solicitation contains sufficient information for offerors to compete intelligently and on equal terms. Phoenix Environmental Design, Inc., B-411746, Oct. 14, 2015, 2015 CPD ¶ 319 at 3.

Unreasonable and Unrelated to Agency Needs

The protesters contend that the requirement for offerors to propose fixed-price, assignable options that could be exercised 15 or 25 years in the future is inherently unreasonable because an offeror has no reliable way of determining the fair market value of its property in the distant future. See, e.g., Protest at 8-9. The protesters further argue that the fixed-price and assignable nature of the options are not reasonably related to the government's articulated need to potentially own the office space it plans to lease.⁵ Id. at 12-13, 19-20. The protesters suggest that a purchase option with a price to be negotiated at the time of exercise would be less burdensome and better aligned with the agency's needs. Id. at 10. The protesters contend that this

⁵ Additionally, the protesters note that the impossibility of accurately estimating the fair market value of commercial real estate 15 or 25 years in the future will prevent the agency from accurately assessing whether the prices offered are fair and reasonable as required by the RLP and regulation. Comments at 13-15. The agency responds by arguing, among other things, that neither regulations nor the RLP require it to specifically assess the price reasonableness of the purchase options because the relevant regulations and RLP terms govern lease terms, but not purchases of property. MOL at 10-13. We do not reach this question because we do not agree with the protesters' underlying premise that it is impossible to make such estimates for the reasons described in this decision. If the agency, as protesters contend, is required to assess the reasonableness of the purchase option price, the agency will be able to perform that analysis using the same types of analytical techniques that offerors may use to develop them. Accordingly, the protesters' contention is, at best, a speculative argument that anticipates improper agency action.

renders the requirement for a fixed-price, assignable purchase option facially unreasonable. Id. at 8.

The agency responds by noting that precisely the same estimating methodologies could be used to estimate a future purchase price as could be used to estimate the fixed-price, 10-year lease extension option required by the RLP, to which the protesters have no objection. MOL at 6-8. The agency notes that ownership of property is generally a lower-cost option for the government when compared to leasing over the long-term, and the ability to purchase the facility could potentially allow it to realize such long-term savings. See MOL at 9-10 (citing Overreliance on Leasing Contributed to High-Risk Designation, GAO 11-879T at 2 (Aug., 2011)). Furthermore, given that the federal budget and appropriations cycle plays out over multiple years, there is significant value to the agency in having a fixed-price purchase option so that the agency can plan and budget years in advance if it intends to exercise the option. MOL at 8-9. The agency additionally argues that the assignability of the options allows the agency to preserve the benefit of its bargain if circumstances should change. Id. at 16-17. For example, if the leased property is no longer suitable as a headquarters for the SEC at the time the option would be exercised, the agency could exchange the option to a third-party for reduced rent at a suitable facility. Id. at 16. The agency argues that, for these reasons, it has previously negotiated similar fixed-price purchase options in similar leases. MOL at 7.

As a preliminary matter, we note that protesters' arguments concerning the difficulty in estimating fair market value are to some extent misdirected because the RLP's purchase option requirement does not compel offerors to accurately estimate the future fair market value of their properties. See RLP at 21. Rather, the RLP requires offerors to set a price that they are willing to accept for the property 15 or 25 years in the future. Id. Even setting that point aside, we do not agree with the protesters that it is impossible to make any estimate of the fair market value of commercial real estate 15 or 25 years in the future. The agency correctly notes that the same estimating tools that an offeror will use to compute the fixed-price rental option could be used to compute the purchase option price. MOL at 6-8.

The protesters argue in response that computing a future fixed-price rental is very different from computing a future purchase price because the value of a building is informed by several factors in addition to rental income, which would render any future estimate of the value of the building entirely speculative. Protest at 9. The protesters suggest that such elements include: building location; access to public transportation; proximity to open spaces; amenities; building age; improvements, common areas, condition of the property, other uses on site, identity and financial strength of other tenants, occupancy rates, and availability of market capital. Id. However, the elements identified by the protesters appear to be factors that would equally and necessarily affect the rental income a building may command. For example, it is unclear why a building's amenities and access to public transportation would not be reflected in the building's rental income rates. Furthermore, the protesters do not make clear what economic value their commercial real estate may have other than the anticipated

stream of future rental income, however estimated.⁶ Accordingly, it is unclear in what way a future estimate of the value of the building will be any more or less speculative than a future estimate of rent, to which the protesters have no objection. The main uncertainty in the estimating process in this case is the offeror's desired return on investment, which only the offeror can decide. See Comments at 5. We find the protesters' contention that it would be impossible to estimate a future purchase price, and that the fixed-price purchase options are therefore facially unreasonable, to be unpersuasive.

This is especially so where the protested purchase option features are clearly related to the agency's articulated needs. Here, the protesters do not object to the agency's need to potentially own the leased real estate at the end of the lease term, but rather contend that the fixed-price and assignable nature of the options are not rationally related to that goal. Comments at 1-2, 7-10. However, the agency has identified capital planning and budget constraints that make a fixed-price purchase option clearly more suited to its needs than a negotiable purchase option.⁷ MOL at 8-9. Likewise, the assignability of the options allows the agency to potentially derive value from the purchase options even if circumstances change such that the agency would not be able to or would not wish to directly exercise the options. Id. at 16-17. In short, both the fixed-price nature of the options and the assignability of the options rationally relate to the government's need to reduce future leasing costs by potentially purchasing the property or properties, because both features make it more likely that the government will be able to gainfully exercise the options to reduce leasing costs. In sum, these elements of the purchase options appear to be reasonably related to the agency's needs.

Unduly Restrictive of Competition and Impermissibly Vague.

The protesters additionally argue that the fixed-price options are both unduly restrictive of competition and impermissibly vague. Comments at 20. Specifically, the protesters contend that, because less burdensome purchase option terms are available, the agency's selection of a fixed-price, assignable purchase option unduly restricts competition. Protest at 10, 23-24. Additionally, the protesters contend that the requirement to estimate a purchase price so far in the future introduces significant

⁶ For example, the protesters do not suggest that their buildings have additional agricultural, industrial, or historic uses that would complicate the estimation of future income from the properties.

⁷ The protesters' argument that the fixed-price option provides no capital planning benefit because the agency must, in any case, appraise the property prior to exercising the option is unconvincing. Comments at 9-10. Notwithstanding that the agency may need to perform an appraisal prior to exercising the option, the fixed-price option provides greater certainty at a significantly earlier point in time than would a negotiable option. The fixed-price option would, accordingly, better facilitate capital planning for the potential purchase.

uncertainty and inappropriate risk, such that offerors are unable to intelligently prepare their proposals and compete on a common basis. Comments at 14-16, 20.

Here, the protesters appear to misunderstand our decisions with respect to solicitation requirements that are unduly restrictive of competition. While it is true that we have sustained protests of solicitation requirements that restrict competition and are not reasonably related to the agency's needs, in those cases the solicitation requirements generally restricted competition by preventing certain offerors from competing. See, e.g., Pitney Bowes, Inc., B-413876.2, Feb 13, 2017, 2017 CPD ¶ 56. In this case, the fact that the RLP contains a purchase option of any kind is what restricts competition because such an option requires that an offeror own (or be able to facilitate the purchase of) the building that it proposes to lease to the agency. RLP at 18, 21. We have seen no convincing argument that a fixed-price or assignable purchase option is any more restrictive of competition than another variety of purchase option, because an offeror capable of responding to an RLP containing any purchase option could also respond to the instant RLP.

In essence, the fixed-price or assignable nature of the option, in isolation, merely affects the desirability of competing for the lease; it does not prevent a firm from competing that otherwise wishes to compete. In this case, the protesters have made clear that they do not object to a purchase option in principle, and have, in fact, submitted an offer under the existing RLP. See Comments at 1-2; MOL at 3. Accordingly, the issue here is not a question of undue restriction of competition--the protesters clearly believed they were able to make a responsive offer to the RLP as written. Rather, the protesters simply dislike the terms on which the government wishes to deal. A protester's disagreement with the agency's judgment concerning the agency's needs and how to accommodate them does not show that the agency's judgment is unreasonable. USA Fabrics, Inc., B-295737, B-295737.2, Apr. 19, 2005, 2005 CPD ¶ 82 at 5.

The protesters' arguments concerning impermissible vagueness are similarly without merit. The government's needs and the terms of the solicitation in this case are not open-ended or undefinitized; they merely impose a readily identifiable risk on offerors.⁸ As noted above, responsive offerors will already own (or be able to own) the facilities in question, so there is no future price uncertainty that could jeopardize an offeror's ability to successfully perform under the option. See RLP at 18, 21. An offeror need not offer any price it could not afford to accept in the future. The only unknowns in this case are the price each offeror is willing to accept for its facility, and how the offeror will view that price in 15 or 25 years.⁹ The proposed purchase options merely allocate a known risk

⁸ Specifically, the risk that the offeror will offer an option price that is below the fair market value of their building in the future.

⁹ Relatedly, the protesters accuse the agency of unfairly seeking a "windfall," effecting a "sham," and imposing an "unconscionable risk" on offerors, because the agency has indicated it would only consider exercising the purchase options if the option price were at or below the fair market value of the property at the time of exercise. Protest at 18;

(continued...)

to the offeror, which is generally unobjectionable.¹⁰ As noted above, an agency may provide for a competition that imposes maximum risks on the contractor and minimum burdens on the agency, provided the solicitation contains sufficient information for offerors to compete intelligently and on equal terms, which this solicitation unquestionably does. See Phoenix Environmental Design, Inc., supra.

Unfair Prejudice

Finally, the protesters contend that the terms of the RLP will unduly prejudice the protesters. Specifically, the protesters argue that the inclusion of the NPV of the purchase options in the agency's price evaluation for determining which offeror is the LPTA offeror will prejudice owners of higher-value buildings, because buildings that have a higher purchase option price will have a higher evaluated price and therefore be disadvantaged in the competition.¹¹ Comments at 13-14. The protesters additionally argue that the RLP's requirement to ensure that any leases to non-government parties be cancellable as of the dates on which a transfer of ownership would occur unfairly

(...continued)

Comments at 14-15. However, we agree with the agency that the protesters appear to misunderstand the nature of an option contract: the fact that an option's price is fixed and may be lower than the fair market value of the asset when the option is exercised is precisely what gives value to such an option. See MOL at 15-16. It would be irrational, absent extenuating circumstances, to exercise a purchase option when the option price exceeded the asset's value. The protesters' argument is, in effect, a generalized complaint about the nature of fixed-price option contracts. The protesters' related argument concerning the possibility of the agency condemning the property if the building's value exceeds the option price is both speculative and a significant distortion of the agency's position. Compare Comments at 8 (claiming that agency has indicated that it will use condemnation if the option price exceeds the fair market value) with MOL at 16 n. 10 (responding to the protesters' prior claims that the government could be bound to pay an option price higher than the price it would pay at condemnation, the agency noted that the purchase option does not bind the government to buy at any price and that the price paid at a hypothetical condemnation would be unrelated to the option price).

¹⁰ The protesters' bare allegation that this sort of risk allocation is unheard of in commercial real estate transactions is unconvincing on this record. See Protest at 9-10. The agency has provided proof that it has negotiated similar terms on several occasions previously, which demonstrates that such transactions do occur. See MOL at 7.

¹¹ In this case, the RLP proposes to evaluate the purchase options on an NPV basis, restricted only to the space the government intends to occupy during the lease. RLP at 25. The latter provision effectively equalizes the comparison between larger and smaller buildings, so the protesters' arguments concerning higher-value buildings can only be meaningfully construed as referring to buildings with a comparatively higher cost per square foot.

prejudices owners of large buildings with non-governmental tenants, such as the buildings owned by the protesters, because it would significantly impair the ability of such an offeror to retain other tenants. Comments at 18-19.

With respect to the protesters' argument concerning high-value buildings, it is clear that an LPTA source selection scheme may not work to the benefit of offerors proposing higher quality items at a higher unit cost. However, what the protesters object to is the defining feature of an LPTA source selection scheme. We have concluded above that including fixed-price purchase options is reasonable in this case; we likewise see no basis to conclude that the evaluation of those purchase options as part of the price evaluation is unfairly prejudicial to any offeror. As long as an agency reasonably identifies its needs and allows offerors the opportunity to meet those needs, the fact that an offeror may have an advantage based on its ability to more readily meet the government's needs, as compared to another offeror, does not mean that the solicitation terms are inappropriate. See HG Props. A, L.P., B-280652, Nov. 2, 1998, 98-2 CPD ¶ 104 at 4-5.

With respect to the protesters' objection to the RLP's limitations on non-governmental leasing, the protesters' concerns, to some extent, mischaracterize the terms of the RLP. The RLP indicates that such leases "should" be cancellable,¹² but expressly contemplates the possibility that non-government leases may run beyond the date on which the option is exercised. AR, exh. 25, RLP Draft Lease, at 47. In the case that some non-governmental leases extend beyond the transfer date, the RLP simply provides that the agency may negotiate a purchase price adjustment on that basis. Id. Furthermore, the provision is clearly and reasonably related to the agency's need to potentially exercise the option--it is not unreasonable for the agency to require that it be able to take possession of a building it has purchased without having to absorb additional costs related to existing leases. While this requirement may ultimately work to the advantage of some offerors and the disadvantage of other offerors, an agency is not required to neutralize a competitive advantage that a potential offeror may have by virtue of its own particular circumstances where the advantage does not result from unfair action on the part of the government. Military Waste Mgmt., Inc., B-294645.2, Jan. 13, 2005, 2005 CPD ¶ 13 at 4.

The protest is denied.

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General Counsel

¹² This is in contrast to other nearby paragraphs which use "must" or "shall" to convey mandatory requirements. See, e.g., AR, exh. 25, RLP Draft Lease, at 47, ¶ 5-6, 9.