



General Services Administration  
Public Buildings Service  
Washington, DC 20405



PQRP-91-02

28 FEB 1991

MEMORANDUM FOR ASSISTANT REGIONAL ADMINISTRATORS FOR PUBLIC BUILDINGS SERVICE - 2P, 3P, 4P, 5P, 6P, 7P, 9P, WP

FROM: ROBERT J. DILUCHIO  
ASSISTANT COMMISSIONER *Robert J. Diluchio*  
FOR REAL PROPERTY DEVELOPMENT - PQ

SUBJECT: Guidance on Negotiation and Administration of the Real Estate Tax Adjustment Clause.

1. Purpose. To provide additional guidance for tax escalation clauses.

2. Background.

a. A review conducted by the Inspector General determined that the Government had been subjected to large real estate tax escalation payments when properties were assessed at below market value at the time that the lease was negotiated. As a result, certain recommendations were made to reduce the Government's potential for excessive real estate tax liabilities.

b. GSA Acquisition Circular (AC-91-1), issued January 22, 1991, revised the prescriptions for use of the GSAR Tax Adjustment Clause, 552.270-24 (6/85). The Circular provides that any clause developed by the contracting officer must provide for a negotiated base tax amount, provide for upward and downward adjustment of the taxes owed by the Government, and specify the time and method by which the Government will make payment to the Lessor.

c. In order to insure that any new clauses that are developed will meet the requirements of the Circular and prevent the recurrence of the circumstances detected during the audit, supplemental language and new substitute clauses have been developed to address the most common situations that are likely to occur. Paragraphs (C) and (D) may remain unchanged unless local conditions are such that use of these paragraphs does not adequately protect the interest of the Government. The attached instructional material will provide the flexibility that contracting officers require for more effective lease negotiations.

3. Effective Date/Expiration Date. These instructions are effective the date of this issuance and will expire 12 months from the date of issuance, unless extended.

4. Cancellation: None.

5. Coverage: All real property leasing activities.

6. Instructions/Procedures. Suggested clauses and implementation instructions are provided for use in special circumstances where:

- o A property is temporarily underassessed as a result of owners' appeals for lower assessments.

- o A building is to be constructed or is under construction, is undergoing conversion to change its character or intended use, or is under renovation for the Government's use and the assessment may change significantly by reason of the renovation or conversion program.

- o The space to be leased may be part of a multi-use complex which has not been subdivided into individual parcels for tax assessment purposes.

- o A property has special tax abatements granted by local taxing jurisdictions or districts such as economic development or enterprise zones.

- o A property may be reassessed to a higher value after sale or change in ownership of the property as may occur in California under Proposition 13.

- o The Solicitation requests a firm term with one or more renewal options.

a. General guidance on determining the circumstances when alternate clauses should be used and on how to evaluate local tax bills is provided in **Attachment 1.**

b. An alternate clause which may be used in the SFO for leases of more than 10,000 square feet is provided in **Attachment 2.**

c. Recommended Alternate Clause for Leases with Option Periods is provided in **Attachment 3.**

d. Office of Real Estate - PR, Policy Memorandum, Subject "Alert System to Reflect Artificially Low Property Assessments in the Real Estate Appraisal Report," October 10, 1985, instructing appraisal staff to include "projected likely market level of tax" in the appraisal report - **Attachment 4.**

e. Leasing Division - PRL, Policy Memorandum PRL 84-18, Subject: "Payment of Real Estate Taxes," Dated November 26, 1984, restated GSA's policy regarding payment of real estate taxes and gave examples of some special taxes that GSA will not pay as part of the real estate tax. - **Attachment 5.**

EXAMPLE

Determining Government's Share by Value Approach

The Government leases 62,000 net usable square feet of office space which is equivalent to 75,000 gross rentable square feet. "Gross rentable" is the only measurement that is available for the entire building, so it will be used for determining the proportional part of the Government's lease. Consistent measurements must be used throughout the calculation whether that be gross square feet, net usable square feet, BOMA, or some other locally adopted standard.

Total gross rentable of the entire property =	100,000 s.f.
Government lease space	Office = 75,000 s.f.
	Retail = 20,000 s.f.
	Parking = 5,000 s.f.

If a total square footage calculation were used, the Government's share would be  $\frac{75,000}{100,000} = .75$  or 75%

For determining the proportion of value contributed, consultation with the appraisal staff and review of other available market data reveals that retail space rents for 140% of office and parking space rents for approximately 25% of office space. Thus, the following calculations are used:

Office =	75,000 x 100% =	75,000
Retail =	20,000 x 140% =	28,000
Parking =	5,000 x 25% =	<u>1,250</u>
TOTAL		104,250

Therefore, the Government's share of the "value" is

$\frac{75,000}{104,250} = .719$  or 71.9%

## ATTACHMENT 1

### Guidance for Negotiating and Administering Tax Escalation Clauses in Government Leases

#### GENERAL:

The rental rate offered to the Government on leases for real property is usually broken down into two categories: (1) base operating expenses and (2) a dollar figure representing "everything else". This "everything else" figure can then be broken down further into two major categories: (1) other expenses and (2) profit. Real estate taxes are one of the items included in "other expenses."

If there is no tax escalation clause included in a lease, the offeror must estimate the risk of increases during the term of the lease. This risk element is then translated by the offeror into a certain cost per square foot and this cost is included in the rental rate. In a very "soft" or competitive market, the offeror may be convinced to risk some of the profit portion of the rental rate since this is the only portion of the rental rate that is discretionary.

With a tax escalation clause (commonly called a "pass-through" clause) the offeror and the government share the risk of tax increases. In this instance, it is important that both parties are cognizant of that portion of the rental rate that will in effect establish the "base" after which tax increases will be paid by the government. The factors that influence this base at lease award are the percentage of occupancy and the assessed value of the leased building.

Following award, the factors that affect the Government's rent include but are not limited to: changes in local law, reassessments, partial assessments, special assessments, reduction in tax liability for hardship, service or user charges, and establishment of special taxing jurisdictions and districts such as economic development or enterprise zones, renovations and alterations in non-government space, sale of the property, change in use.

1. For leases of less than 10,000 square feet it is recommended that the standard Tax Adjustment Clause, 552.270-24 be used unless the Contracting Officer determines that an alternate clause will best serve the interests of the Government.

2. After the market survey is completed and it is determined that there may be offers of new construction involving major renovation or conversion, the appraisal staff will be consulted to provide information to assist the Contracting Officer in selecting the appropriate tax escalation clause and in negotiating the base year or the base tax dollar amount. To ensure proper implementation of any alternate tax adjustment clause or paragraph, the leasing staff must work closely with the appraisal staff to obtain the necessary information to negotiate an appropriate tax base. In addition, the Contracting Officer should consult with the appraisal staff to determine if any part of the delineated area falls within a special taxing jurisdiction, district or zone.

3. Where the property or building in which the Government leases space contains only one use, e.g., office, warehouse, etc., the Government's share will be determined as a percentage of the total property or building. This percentage will be obtained by dividing the number of square feet of the Government's lease by the total square feet in the property. The same measurement standard will be used for both the Government's area and the total area in the building, whether that be net usable, net rentable, or some other measurement used in the particular market.

4. The method of determining the Government's share of leased space may, where appropriate, be the prorata share based on the income that each type of use contributes to the total value of the property. This method may be more appropriate in a mixed use development with several uses such as office, retail, and parking. This is possible, and more appropriate than percentage of square footage, when the taxing jurisdiction uses the income approach in determining the assessed value for commercial properties.

5. When using the value approach, the realty specialist should work with the appraisal staff to determine weights to be assigned to each category of use in the property. The following is one example of assigning weights. This ensures that the Government pays only its fair share based on the value that the Government leased space contributes to the total value of the property.

See EXAMPLE on following page.

6. Tax payment receipts and invoices received from lessors and offerors should be reviewed carefully to:

- o verify the property identification, e.g., folio, Libra, tax map, block number, lot number, etc.;
- o note any changes in assessments, being alert to any changes due to additions or changes to the building or land;
- o ensure that special assessments or charges not specifically in the category of general real estate taxes are deducted;
- o calculate appropriate amount if lessor received discount for early payment;
- o deduct any penalty or interest for late payment; and
- o check the lessor's calculation.

Failure of a Lessor to submit tax bills within the 60-day period may signal that a reduction in the tax amount has occurred. The Lessor should be contacted in writing to request copies of the bills for review. The Contracting Officer may also arrange to obtain a copy of the tax bill directly from the appropriate taxing authority.

7. The Contracting Officers are advised to properly document negotiation records to demonstrate that tax costs were considered during negotiations and that appropriate action was taken to avoid excessive tax escalation payments, especially in those cases where the appraisal has indicated a discrepancy between current taxes and market level taxes on comparable properties.

Specialists should document all pre and post negotiations with lessors relative to the tax clause, including, but not limited to:

- o any adjustment to the tax base or to the Government's share;
- o modifications to the dates for submission of notices;
- o challenges of assessment value; and
- o agreements to share costs of appeal.

ATTACHMENT 2

Recommended Alternate Clause for  
Leases of More Than 10,000 Square Feet

For the majority of new leases negotiated, the standard clause in the automated solicitation for offers will be adequate (GSAR 552.270-24). The following Alternate Tax Escalation Clause may be used where appropriate. In addition, the Regional Real Estate Directors may develop substitute paragraphs to meet specific regional needs. New substitute paragraphs should be cleared through the appropriate Regional Counsel and Office of Real Property Development (PQRP) before issuance of a solicitation.

(A) The Government shall make an annual lump sum adjustment, as additional payment to or deduction from, its share of any increase or decrease in real estate taxes that are assessed over the agreed upon base year or negotiated dollar amount. The base year shall be the first 12-month period of the lease term coincident with full assessment or a negotiated dollar sum that reflects a fully assessed value for the property.

(B) Full assessment is defined as the assessed value of a fully occupied property after completion of all construction, renovation or conversion for the intended use of the Government. Full assessment does not occur until after the expiration of any and all special assessments or reduction in tax liability for hardship and for special taxing jurisdictions and districts such as economic development or enterprise zones. Partial assessments for newly constructed projects or for projects under construction or partially completed projects, renovations, or conversions will not be used for establishing the Government's base year for tax and rental adjustment payments.

(C) Real estate taxes are defined as taxes which are assessed on an ad valorem basis against all taxable real property within the jurisdiction of the taxing authority, without regard to any benefit to the property, and the revenues collected are used by the taxing authority for the purpose of providing general services. The Government will not pay special assessments, service or user charges, licenses, fees, or taxes on related personal property.

(D) If during the term of the lease, the property covered by the assessment is enlarged, decreased, or altered in any way or there is a change in the manner or method used by the taxing jurisdiction in determining the assessed value of the property such that there is a change in the Government's share, the Government shall negotiate with the lessor to adjust the base to reflect the Government's actual share of the new assessed value.

(E) The Government's share of tax increases shall be based upon the ratio of the assessed value of the space leased by the

ATTACHMENT 3

Recommended Alternate Clause for

Leases with Option Periods

If the Government exercises an option to extend the lease term at the same or lower rate as that of the original term, annual tax adjustments will continue on the original or otherwise negotiated base year or dollar amount. Should the renewal option rate be higher than the total rental in effect on the last day before the renewal period begins, including operating and tax escalations, the base period will be reestablished as the first lease year of the renewal period.





OCT 10 1985

Re: to Office of Real Estate - PR  
Attn of:

Subject: Alert System to Reflect Artificially Low Property Assessments in  
the Real Estate Appraisal Report

To: Regional Directors, Appraisal Staff  
1PZ, 2PEZ, 3PEZ, 4PZ, 5PZ, 6PEZ, 7PZ, 8PEZ, 9PZ, 10PZ, WPZ

This policy memorandum details the research and analysis requirements for the Appraisal Staff in checking on the validity and magnitude of real estate tax assessments in all appraisal cases involving the acquisition of 10,000 or more square feet.

In a recent audit report (Review of Payments made under the Tax Escalation Clause for Leases in the District of Columbia, A40620/P/T/T 5024, dated June 4, 1985) it was determined that the Government could be subjected to extraordinary tax escalation payments. This exposure results from the establishment of an unusually low tax base for the purpose of computing future tax escalation liabilities. This low base year tax is usually the result of one or more of the following circumstances:


- a) a property under construction which has not yet been fully assessed,
- b) a property undergoing major renovation which is likely to change the character and subsequently the assessment of the property, or
- c) a property where the assessment may have been lowered based on an appeal (often related to a temporarily reduced cash flow from old leases) and where the higher market assessment will likely be restored after the advent of new market rate leases.

The appraisal process requires the appraiser to analyze the current tax on the subject property in supporting his estimate of the market level of real estate tax used in the reconstructed operating statement. Unusually low or high tax loads can be identified by a study of past tax trends, present levies, future revenue expenditures of the taxing authority, and comparison of the tax treatment of the subject property with the treatment of similar properties in the same tax area. Updates of previous assessments which were successfully appealed and methods employed by the local taxing authority will also give indications of the proper market tax level. The shortcut method of multiplying the appraised value by the local millage and assessment rate should not be used, unless it duplicates local methods.

Attachment # 4

Effective this date, the appraiser is required to include in the tax section of each appraisal (over 10,000 square feet), not only the current real estate tax, but also the projected likely market level of tax. If the current tax is found to be at market level then both entries will reflect the same amount. Substantially lower current tax amounts when compared to the estimated market tax amount for the property will serve to alert the real estate divisions to artificially low tax payments.

The real estate tax section of the appraisal report should include all pertinent tax data developed in the data search phase of the appraisal process. This might include any tax exempt status, forthcoming tax increases or decreases which will be of importance to the real estate division in negotiating the tax escalation clause with the prospective lessor.

*for*   
THOMAS M. SHERMAN  
Acting Assistant Commissioner  
for Real Estate

cc: Regional Administrators  
1A, 2A, 3A, 4A, 5A, 6A, 7A, 8A, 9A, 10A, WA  
Assistant Regional Administrators for Public Buildings and  
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PRI 84-18

NOV 26 1984

to :  
of : Leasing Division - PRL

Subject: Payment of Real Estate Taxes

To : All Real Property Leasing Activities (PRL Distribution List)

1. Purpose.

- a. To remind real property leasing activities of GSA's policy regarding the payment of real estate taxes under the tax escalation clause.
- b. To give examples of some of the special taxes that should be reviewed on a case-by-case basis to determine whether we should pay them.

2. Background.

In a recent case before the GSA Board of Contract Appeals, the Board ruled that special assessments are not to be considered when calculating adjustments under our real estate tax clause. The Board's ruling overturned a final decision mistakenly rendered by a GSA contracting officer. The contracting officer, as part of the tax escalation clause, paid special assessments (drainage and downtown improvement taxes) on a building in which the Government occupied space.

3. Coverage. All real property leasing activities.

4. Procedure.

- a. It has been and continues to be our policy that the Government will pay only those real estate taxes that are for the purpose of funding general services of the taxing jurisdictions. Such taxes are defined as taxes which are assessed on an ad valorem basis against all taxable property in the taxing jurisdiction without regard to benefit to the property. The city, state, and school components of the real estate tax are typical examples of taxes that the Government will pay.
- b. It is our policy that the Government will not pay taxes which may be categorized as benefits and harm avoidance payments which offer greater benefits to the property owner than to temporary occupants of the building. Typical examples of taxes the Government will not pay include user charges, licenses, special improvement taxes, commercial zone usage charges, vault tax, metropolitan district charges, front footage charges, streetlight

maintenance charges, downtown redevelopment charges, road and bridge taxes, canal district taxes, etc. This list is not complete, and other special assessments may be included in the tax bill.

In some jurisdictions, special assessments are listed separately on the tax bill. In other jurisdictions, they may not be separately identified. In those cases, you must take special care to ensure that they are not passed on to the Government as part of the general real estate tax increases. As a rule of thumb, whenever there is a charge on the tax bill and there is no tax rate associated with that charge, you should be alerted to the possibility that the charge is a special assessment.


You should review all tax bills very carefully and get a legal opinion each time one of these special assessments appears or may be included. It is essential that a consistent position is taken within each jurisdiction so that we do not put ourselves in the position of paying the assessment for one building and denying it for another.

Please note that in some jurisdictions, water and sewer charges, snow removal, or rubbish/trash removal charges may also be included in the tax bill. They should not be paid as part of real estate tax escalation. These are operating expenses which rightfully should be considered under a lease clause pertaining to the escalation of operating expenses.

5. Implementing instructions. These procedures are applicable to tax escalations processed by the regional leasing branches after the date of this memorandum. We recognize that staffing and other constraints will not permit an across-the-board analysis of prior tax payments. However, you are not precluded from reviewing previous tax payments for selective cases and determining, with the concurrence of regional counsel, to pursue reimbursement for any payments clearly made in error.

*David L. Bibb*

DAVID L. BIBB  
Acting Assistant Commissioner  
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Concurrence: 

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