General Services Administration
Public Buildings Service
Washington, DC 20405

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PRL 83-10

Reply to Attn of: Office of Space Management - PR

Subject: Buying out of vacant leased space (PBS P 1600.1A, Chapter 6)

To: Regional Administrators, GSA
WA, 1A, 2A, 3A, 4A, 5A, 6A, 7A, 8A, 9A, 10A

This memorandum will supplement Chapter 6 of the Leasing Handbook, which establishes a general policy of negotiating buy outs of vacant leased space whenever possible. Our purpose here is to emphasize that policy and to provide procedures for effecting buy outs. Accordingly, it shall be the policy to reduce vacant leased space in the inventory to the greatest extent practicable through buy outs of lease contracts when conditions indicate that such action is economically prudent, feasible, and in the best interest of the Government as defined below.

Upon identification of vacant space, and a determination that no further need for it exists, the lessor should be immediately notified of the Government's desire to terminate the contract. In addition, when you anticipate that space will actually be vacated, negotiations should be initiated relative to the reduction of services and utilities for those leases that do not contain the "Adjustment for Vacated Premises" clause which is currently part of the automated SFO. For leases which contain this clause the reduction in rent should be calculated and included in the notification to the lessor of the intent to vacate.

A thorough analysis of market conditions is required to develop a strategy from which to commence buy out negotiations. Our negotiating posture will vary depending upon the specific terms of the lease and current market conditions. For instance, our analysis could, in one extreme, indicate an advantage to the lessor to pay the Government to terminate the contract. In those cases where the Government does have an advantageous "leasehold interest," vigorous negotiations should pursue payment from the lessor. This may be especially true for those circumstances where the Government holds long-term renewal options which are substantially below market rents.

At the other extreme, it may be necessary for us to buy out at the full present worth of the net rent for the remainder of the lease term. If a buy out program is to succeed, there can be no substitute for the experience, knowledge of the market, and good judgment of the real estate and appraisal staffs.

If the space to be vacated is in excess of 10,000 net usable square feet, an appraisal and economic analysis must be requested from the appraisal staff. This can be initiated on the Standard Form 66. Three values should be requested from the appraisal staff: the current fair annual rental (FAR), the present value of the Government's contractual obligation over the remaining term of the lease (PVG) and the fair value of a negotiated lease buy out (B). This appraisal and valuation service may, of course, also be requested upon the discretion of the contracting officer for leases under 10,000 net usable square feet.

Although it is our policy to give first priority to the consideration of buying out of vacant, unneeded space, a submission including standard form 118 should also be prepared and transmitted to the Utilization Branch in order that appropriate initial preparations for outleasing may proceed simultaneously with the negotiations to buy out of the lease. This will save time if it becomes apparent that a buy out agreement cannot be reached and the decision is made to pursue an outlease.

Enclosed is a formula and a sample buy out calculation which may be of assistance as a guide for analyzing specific cases and developing a buy out negotiation strategy. This is offered as an attempt to take into account many of the variables which influence a buy out settlement. The formula permits the calculation of the factor "PVG" which represents the present value of the Government's contractual obligation. This is the starting point of any buy out exercise, and represents the maximum or upper limit for a buy out settlement. More favorable terms can usually be obtained through negotiations.

The factor "B" is a fair buy out price taking into consideration mitigating factors such as the potential for obtaining a replacement tenant, thereby reducing the Government's liability. This should be treated as the negotiation objective or goal. If a negotiated buy out exceeds B and cannot be reached below 80 percent of the PVG, the approval of the Assistant Regional Administrator for Public Buildings and Real Property must be obtained.

If an acceptable agreement cannot be negotiated, immediate action should be taken to outlease the space for the remainder of the term. All negotiations, those resulting in buy outs, as well as outlease referrals, should be thoroughly documented by price negotiation memoranda to demonstrate that the action taken best serves the Government's interest.

Contract clearance thresholds shall apply for buy out negotiations as well as other contract modifications. These thresholds currently require pre-award approval by the regional Office of Project Control and Oversight when a buy out will exceed $100,000. Pre-award approval by the Office of Acquisition Policy will also be required if the buy out exceeds $250,000.

The Office of Acquisition Management and Contract Clearance (VC) has offered the attached file format which is suggested for general use and is appropriate for contract clearance submissions.

If you have any questions concerning this procedure, please call David Bibb of the Leasing Division on FTS 566-0638.

Richard O. Haase

RICHARD O. HAASE
Commissioner

Enclosures

cc: Assistant Regional Administrators for Public Buildings & Real Property
WP, 1P, 2P, 3P, 4P, 5P, 6P, 7P, 8P, 9P, 10P
Regional Directors, RED
WPE, 1PE, 2PE, 3PE, 4PE, 5PE, 6PE, 7PE, 8PE, 9PE, 10PE
Associate Administrator for Operations (AR)
Assistant Inspector General for Audits (JAR)
Director, Office of Acquisition Management & Contract Clearance (VC)
All Directors, Field Audit Office (JA-1 through 10 and JA-W)

ATTACHMENT A

CLEARANCE FILE

BUYOUTS

Tab 1	Determination from A&U that no further need exists for space
Tab 2	Analysis of Market Conditions
Tab 3	Notification to lessor of Government's desire to terminate including action under "Adjustment for Vacated Premises" clause or negotiations to reduce services
Tab 4	Appraisal of FAR, PVG, and B Formula calculations (PVG - M = B)
Tab 5	N/A
Tab 6	PNM Lessor's offer
Tab 7	Supplemental Lease Agreement Inspection Report, if appropriate
Tab 8	Approvals, Legal Concurrence

ATTACHMENT B

The following formula is to be used to establish an equitable value to buy out of a lease contract:

PVG - M = B

I. DEFINITIONS

- PVG is the present value of the Government's contractual obligation over the remaining firm term of the lease.
- M is the value of mitigating factors which will offset the Government's liability.
- B is the negotiation objective being a fair compensation to the lessor to terminate the lease.

II. PROCESS

STEP 1: ESTABLISH THE ABSOLUTE MAXIMUM DOLLARS THAT CAN BE PAID TO THE LESSOR TO BUY OUT OF A LEASE (PVG).

— In order to identify the negotiating objective for a buy out (B),it is first necessary to compute the present value of the Government's rental obligation over the remaining term of the lease (PVG).

(A) Take current gross annual rent based on the lease contract. (Do not include monthly payments to amortize alterations unless they are paid without interest.)

(B) Subtract the annual rental reduction for services not furnished for vacant space.

In many leases, there is a provision for a reduction in the Government's rental obligation equal to the amount attributable to certain operating costs, such as cleaning, which will not be required upon the Government's vacating the premises. (In the automated Solicitation for Offers, the clause is entitled "Adjustment for Vacated Premises.") If there is no lease provision, then use the annual amount of any negotiated agreement for reduction of services.

(C) Divide the resulting dollar amount by 12 months to arrive at a monthly rental figure. Multiply the resulting dollar amount by the present value factor for the number of months and/or years remaining under the lease contract.

To identify the appropriate interest rate table to be used, consult the regional appraisal staff. Once the interest rate has been determined, find the present value factor on the fifth column of the corresponding Monthly Compound Interest Table. An example of these tables is included as Attachment B. If the monthly compound interest tables do not include the interest rate or number of months needed, the figures may be interpolated. (Consult the appraisal staff if assistance is needed).

(D) Add any contractual obligations not covered above, such as restoration specifically required in a lease for alterations associated with Government's occupancy.

(E) Add the remaining balance (principal only) of any unamortized alterations to calculate the amount owed. To find the remaining balance if unattainable through the lessor, or unknown, use the following formula:

$$\frac{(A - I)}{(AA - I)} = P$$

Where: A= annual constant (use the amortization table for the interest rate negotiated). An example of this table is included as Attachment C. Find the number of years (or months) over which the alterations were amortized. Read across to column 7 "Annual Constant for Monthly Payment." If the monthly compound interest tables do not include the interest rate or number of months needed, the figure may be interpolated.

AA = Annual constant required to amortize entire costs to date. (Use the same amortization table. Find the number of years (or months) which have already transpired. Read across to column 7.) If the monthly compound interest tables do not include the interest rate or number of months needed, the figure may be interpolated.

I = Actual interest rate negotiated for the amortized alterations.

P = percentage of alterations paid off

(F) The sum of the above steps establishes the present value of the Government's obligation (PVG) or the upper limitation of the buy out.

STEP 2: IDENTIFY MITIGATING FACTORS (M)

Some considerations to be evaluated are as follows:

A. What is the likelihood that a replacement tenant can be found?

This will be reflected by supply and demand for this type of space in the market.

- Check the vacancy rate for area. Sources for this information include BOMA publications, the Howard Ecker & Co. Report, appraisal staff and personal knowledge from market surveys.

B. How long will it take to find a new tenant and have them in place and paying rent?

Is the space generally in good condition and free of unusual alterations so that it could be occupied with a minimum of repairs or refurbishing?

- The market will indicate how long it can be expected to take to have a replacement tenant in place, assuming a fair market rent is sought.

C. Can the lessor obtain a net rental which is equal to or excess of the Government's contractual obligation?

- This is where good information and knowledge of market rates come into play. Generally, the older the subject lease, the more likely it is that market rents will have increased. Special circumstances such as a remote location, however, may command lower rents or, in the extreme, there may be no demand for the space.

D. Marketing expenses, such as advertisements or leasing commissions must be accounted for.

- The cost of obtaining a replacement tenant must be considered. Leasing commissions may vary from one situation or market to another, however 2.5 percent of the adjusted gross rent over the lease term is a good general commission factor.

- If there have been alterations unique to the Government's occupancy and not suitable for the private sector, the cost of returning the space to building standard may be considered as a factor. (It should be pointed out that determining the cost of restoration is one of the more complex appraisal tasks and it is recommended that assistance be sought from the appraisal staff for cases where this is a consideration.)

STEP 3: DEVELOP NEGOTIATION OBJECTIVE (B)

In any event, a negotiation objective must be what it says it is, a goal or starting point. A negotiated settlement may still be reached, if properly justified and documented, up to the maximum allowable payment, PVG. Any settlement which is negotiated in excess of 80 percent of the PVG must be approved by the Assistant Regional Administrator.

When a settlement agreement is reached, contract clearance must be obtained in accordance with the thresholds for modifications of Real Estate Division Contracts. This pre-award review submission should include all applicable market survey, appraisal, and price negotiation memorandum documentation. The buy out should then be culminated with an executed Supplemental Lease Agreement.

If it becomes apparent that an equitable buy out agreement cannot be reached through negotiations, then the space will be referred to the Utilization Branch to pursue an outlease.

III. EXAMPLE

Background Information for Case Study:

Let us contemplate a 5-year lease for 3,000 square feet effective on February 3, 1982. The space has become vacant with no prospect for backfill by a Federal agency:

- The current annual rental is $24,000 or $8.00 per net usable square foot (NSUF), fully serviced. This contract rent includes the amortization of some initial alterations.

- It is also assumed, for this example, that the lease provides for annual tax and operating cost escalation. The percentage of Government occupancy is 10 percent. The base for operating costs is $2.50 per square foot. Real estate taxes for the subject property have increased from $28,000 in 1982 to $36,000 in 1983.

- The lease contains an adjustment for vacated premises clause whereby the rental can be reduced by $2.00 per NUSF for unrequired services. (The annual reduction is $6,000.00.)

- In addition to rent, the Government entered into an agreement at the beginning of the lease to amortize $15,000 worth of special initial tenant alterations over the 5-year term of the lease, at an interest rate of 15 percent. Therefore, $4,282.20 per annnum is paid in addition to the base rent by virtue of the amortization.

- For this example which takes place in February of 1983, let us assume that the leasing market is strong, and we estimate that the space will be leased by another tenant within 4 to 6 months.

- Finally, it is also assumed that slowly rising market rental rates will insure a replacement rental rate at least equal to the Government's lease.

Step 1:

(A)	gross annual rent	$	24,000.00
	deduct annual payments to amortize alterations		- 4,282.20
	adjusted gross rent	$	19,717.80

(B) deduct for reduced services per lease clause - 6,000.00

(C) dollar amount resulting from steps A-B = $13,717.80 annual rent

Divide by 12 months = $1,143.15 monthly rent

(D) not applicable in this case

The appraisal staff has informed you that the percentage rate needed to find the present value factor is 10 percent.

Next, find the present value factor for 48 months (4 years) on the fifth column of the 10 percent monthly compound interest table indicated on Attachment B.

Substituting these numbers in the equation we find the following:

$1,143.15 X (39.428160)= $45,072.30

(E) Now, add the remaining balance owed for alterations which are being amortized over the term of the lease.

($15,000 total to be paid over 5-year lease term at 15 percent)

Use the following formula:

$$\frac{(A-I)}{(AA-I)} = P$$

Use the amortization table for 15 percent (refer to Attachment C). Go to column 7 "Annual Constant" and read down to total number of years over which alterations were to be amortized. Therefore, "A" equals .2854792

Now calculate "AA" by using the same table. Read down column 7 to the number of years over which alterations have already been paid. If the time elapsed is not a complete year (e.g., 1 year and 3 months), then you must interpolate. Ask the regional appraisal staff for assistance.

"AA" is 1.0830997
"I" is 15 percent

$$\frac{.2854792 - .15}{1.0830997 - .15} = \frac{0.1354792}{0.9330997} = 0.14519263$$

The percentage of alterations paid during the first year of the lease is, therefore, .14519263, rounded to 14.52 percent.

Multiply this percentage by total alteration cost: $ 15,000 X .1452 = $2,178 This is the amount which has been paid.

Amount of alterations	$15,000	
Subtract amount paid -	2,178	
	$12,822	This is the unpaid balance owed for the alterations

(F) Calculate present value of Government's obligation (PVG) by adding the products of steps C and E.

Step 1(C)	$ 45,072.30	
Step 1(E)	+$ 12,822.00	
PVG	$ 57,894.30	This is the maximum amount which can be paid for buy out

Step 2: Identify mitigating factors (M)

(A) The vacancy rate for office space in downtown Metropolis is 4 percent. It is estimated that a reasonable period for obtaining a replacement tenant would be 6 months.

In step 1 (C), the present value of the rental to be paid for the remaining lease term is determined to be $45,072.30.

This amount will, therefore, be offset by the rental the lessor would be receiving from a replacement tenant for 3 years and 6 months of the remaining 4-year lease term.

To calculate this offset, use the rental figure from the beginning of step 1(C), or $1,143.15 per month.

Use the same 10 percent monthly compound interest table (Attachment B).

Go to Column 5 "Present Value".
Read down the column to 4 years (48 months)

4-year factor	39.428160
Subtract factor for 6 months	- 5.828817
This is the Present value Factor for 3 years and 6 months	33.599343
Multiply by monthly rent	x $1,143.15/mo
	$38,409.09
rounded to:	
This is the value of the offsetting rental which the lessor is likely to receive from replacement tenant	$38,400.00

(B) The lessor's taxes, however, have increased by $8,000, 10% of this increase, or $800 would be paid under the Government's tax escalation provisions. (Any future tax increases or decreases will be addressed by the terms of a replacement lease).

(C) Slowly rising market conditions prevail in the downtown area, therefore, the lessor should be able to obtain a rent at least equal to the Government's contract. Therefore, no adjustment to rental rate is used.

Note: Current market information is essential to the analysis of mitigating factors. Some areas of the country are experiencing declining rental rates at the present time.

(D) Marketing expenses are estimated to be as follows:

$19,717.80	- adjusted gross annual rent from step 1 (A)
X 4	- years remaining under lease
$78,871.20	- total adjusted gross rental
X.025	- percentage of gross for leasing commission
$ 1,971.78	
rounded to: $ 2,000.00	- marketing expenses

Summary: Mitigating Factors

Step 2 (A)	Likely rent from a replacement tenant	$38,400.00
Step 2 (B)	Adjustments for tax and operating escalations of the subject lease	(-$800.00)
Step 2 (C)	Adjustments for current rental rates	-0-
Step 2 (D)	Adjustments for marketing expenses	(-$2,000.00)
	Total of likely mitigating factors	$35,600.00

Step 3: Calculation of Negotiating Objective

PVG - M = B

$57,894.30	(PVG)	Step 1 Total
- 35,600.00	(M)	Step 2 Total
$22,294.30	(B)	

ATTACHMENT C,

15% RATE 1 YEARS	1 AMOUNT OF $1 The amount to which $1 will grow with compound interest	2 AMOUNT OF $1 PER YEAR The amount to which $1 per year will grow with compound interest	3 SINKING FUND FACTOR The amount per year which will grow with compound interest to $1	4 PRESENT WORTH OF $1 What $1 due in the future is worth today	5 PRESENT WORTH OF $1 PER YEAR What $1 payable yearly is worth today	6 PARTIAL PAYMENT The yearly installment to repay $1 with interest	ANNUAL CONSTANT FOR MONTHLY PAY'T LOAN Annual debt service per $1 of loan (Divide by 12 to obtain monthly payment)
1	1.150 000	1.000 000	1.000 000	.869 565	.869 565	1.150 000	$\boxed{1.083\ 0997}$ AA
2	1.322 500	2.150 000	.465 116	.756 144	1.625 709	.615 116	.581 8398
3	1.520 875	3.472 500	.287 977	.657 516	2.283 225	.437 977	.415 9839
4	1.749 006	4.993 375	.200 265	.571 753	2.854 978	.350 265	.333 9690
5	2.011 357	6.742 381	.148 316	.497 177	3.352 155	.298 316	$\boxed{.265\ 4792}$ A
6	2.313 061	8.753 738	.114 237	.432 328	3.784 483	.264 237	.253 7402
7	2.660 020	11.066 799	.090 360	.375 937	4.160 420	.240 360	.231 5611
8	3.059 023	13.726 819	.072 850	.326 902	4.487 322	.222 850	.215 3449
9	3.517 876	16.785 842	.059 574	.284 262	4.771 584	.209 574	.203 0920
10	4.045 558	20.303 718	.049 252	.247 185	5.018 769	.199 252	.193 6019
11	4.652 391	24.349 276	.041 069	.214 943	5.233 712	.191 069	.186 1098
12	5.350 250	29.001 667	.034 481	.186 907	5.420 619	.184 481	.180 1052
13	6.152 788	34.351 917	.029 110	.162 528	5.583 147	.179 110	.175 2345
14	7.075 706	40.504 705	.024 688	.141 329	5.724 476	.174 688	.171 2448
15	8.137 062	47.580 411	.021 017	.122 894	5.847 370	.171 017	.167 9505
16	9.357 621	55.717 472	.017 948	.106 865	5.954 235	.167 948	.165 2124
17	10.761 264	65.075 093	.015 367	.092 926	6.047 161	.165 367	.162 9241
18	12.375 454	75.836 357	.013 186	.080 805	6.127 966	.163 186	.161 0029
19	14.231 772	88.211 811	.011 336	.070 265	6.198 231	.161 336	.159 3838
20	16.366 537	102.443 583	.009 761	.061 100	6.259 331	.159 761	.158 0147
21	18.821 518	118.810 120	.008 417	.053 131	6.312 462	.158 417	.156 8541
22	21.644 746	137.631 638	.007 266	.046 201	6.358 663	.157 266	.155 8677
23	24.891 458	159.276 384	.006 278	.040 174	6.398 837	.156 278	.155 0278
24	28.625 176	184.167 841	.005 430	.034 934	6.433 771	.155 430	.154 3115
25	32.918 953	212.793 017	.004 699	.030 378	6.464 149	.154 699	.153 6977
26	37.856 796	245.711 970	.004 070	.026 415	6.490 564	.154 070	.153 [illegible]
27	43.535 315	283.568 766	.003 526	.022 970	6.513 534	.153 526	.152 [illegible]
28	50.065 612	327.104 080	.003 057	.019 974	6.533 508	.153 057	.152 3446
29	57.575 454	377.169 693	.002 651	.017 369	6.550 877	.152 651	.152 0157
30	66.211 772	434.745 146	.002 300	.015 103	6.565 980	.152 300	.151 7333
31	76.143 538	500.956 918	.001 996	.013 133	6.579 113	.151 996	.151 4909
32	87.565 068	577.100 456	.001 733	.011 420	6.590 533	.151 733	.151 2826
33	100.699 829	664.665 524	.001 505	.009 931	6.600 463	.151 505	.151 1037
34	115.804 803	765.365 353	.001 307	.008 635	6.609 099	.151 307	.150 9499
35	133.175 523	881.170 156	.001 135	.007 509	6.616 607	.151 135	.150 8176
36	153.151 852	1014.345 680	.000 986	.006 529	6.623 137	.150 986	.150 7038
37	176.124 630	1167.497 532	.000 857	.005 678	6.628 815	.150 857	.150 6060
38	202.543 324	1343.622 161	.000 744	.004 937	6.633 752	.150 744	.150 5218
39	232.924 823	1546.165 485	.000 647	.004 293	6.638 045	.150 647	.150 4493
40	267.863 546	1779.090 308	.000 562	.003 733	6.641 778	.150 562	.150 3869
41	308.043 078	2046.953 854	.000 489	.003 246	6.645 025	.150 489	.150 3332
42	354.249 540	2354.996 933	.000 425	.002 823	6.647 848	.150 425	.150 2870
43	407.386 971	2709.246 473	.000 369	.002 455	6.650 302	.150 369	.150 2472
44	468.495 017	3116.633 443	.000 321	.002 134	6.652 437	.150 321	.150 2129
45	538.769 269	3585.128 460	.000 279	.001 856	6.654 293	.150 279	.150 1834
46	619.584 659	4123.897 729	.000 242	.001 614	6.655 907	.150 242	.150 1579
47	712.522 358	4743.482 388	.000 211	.001 403	6.657 310	.150 211	.150 1360
48	819.400 712	5456.004 746	.000 183	.001 220	6.658 531	.150 183	.150 1172
49	942.310 819	6275.405 458	.000 159	.001 061	6.659 592	.150 159	.150 1007
50	1083.657 442	7217.716 277	.000 139	.000 923	6.660 515	.150 139	.150 0870