REVIEW OF
PROPOSED LEASE PAYMENT RECOVERIES
NORTHEAST AND CARIBBEAN REGION
REPORT NUMBER A080179/P/2/R09003

JULY 24, 2009

General Services Administration
Office of Inspector General
Jacob K. Javits Federal Building
New York, NY 10278

Date:	July 24, 2009
Reply to Attn of:	Howard R. Schenker Regional Inspector General for Auditing, New York Field Office (JA-2)
Subject:	Review of Proposed Lease Payment Recoveries Northeast and Caribbean Region Report Number A080179/P/2/R09003
To:	John Scorcia Regional Commissioner, Public Buildings Service (2P)

In response to a request from the Director, Real Estate Acquisition Division (formerly known as the Account Management Division), Northeast and Caribbean Region, the Office of Inspector General has reviewed eight proposed lease payment recoveries as calculated by PRG-Schultz USA, Inc. (PRG), a GSA cost recovery contractor.

Background

On January 16, 2003, OMB issued guidance to all executive departments and agencies citing the Administration's Improved Financial Performance initiative to reduce erroneous payments made by the Federal government. Per OMB, "erroneous payments waste taxpayer dollars and divert resources from their intended beneficiaries."

In keeping with this initiative, Section 831 of the National Defense Authorization Act for Fiscal Year 2002 requires that agencies that enter into contracts with a total value in excess of $500 million in a fiscal year must carry out a cost-effective program for identifying errors made in paying contractors and for recovering amounts erroneously paid to the contractors. A required element of such a program is the use of *recovery audits* and recovery activities.

A *recovery audit* is a review and analysis of the Government agency's books, supporting documents, and other available information supporting its payments that is specifically designed to identify overpayments to contractors that are due to payment errors. It is not an audit in the traditional sense. Rather it is a control activity designed to assure the integrity of contract payments, and as such, it is a management function and responsibility.

As a participant in this initiative, GSA has engaged PRG-Schultz International, Inc. (PRG) as its contracted recovery auditor. PRG reviews payments related to leasing, building services, supply and information technology to identify erroneous payments. According to GSA's Chief Financial Officer, as of September 30, 2007, PRG has identified $53 million in erroneous payments, of which $35 million was successfully recovered.

In fiscal year 2008, PRG performed a recovery audit of lease payments in Region 2. On April 16 and June 3, 2008, PRG provided the Region with results that identified potential overpayments totaling $1,830,364 associated with 25 of the leases that they reviewed. The Director of Region 2's Account Management Division assigns staff to review the results received from PRG. To augment this staff review process, the Director also requested that the Office of Inspector General review eight of PRG's results before they approached the lessors to request refunds. This report presents the results of our review of these eight files.

Objectives, Scope and Methodology

Our audit objectives were to determine whether: (1) PRG's calculation of the proposed lease payment recoveries are accurate and supported by appropriate records and lease clauses and (2) real estate tax escalation payments were properly supported.

To accomplish these objectives, the auditor:

(1) reviewed original and supplemental lease agreements for clarification of terms and conditions;

(2) reviewed Lease Digest Action (GSA Form 620) forms for proper authorization of lease payments;

(3) reviewed Operating Cost Escalation Worksheets for verification of the lease escalation increases;

(4) retrieved and analyzed data from GSA's Pegasys system for confirmation of monthly lease payments made by GSA's Finance Division;

(5) analyzed PRG's methodology and supporting schedules used for calculating the proposed lease payment recoveries;

(6) reviewed real estate tax computation worksheets, municipal tax records and other supporting documentation used in calculating the appropriate real estate tax escalation payments due; and

(7) interviewed GSA Account Management Division and Realty Support Branch officials to obtain background information and to determine the proper application of various lease terms and conditions.

Results of Review

As a result of our review of eight lease files, we have identified an additional $157,956 of potential lease payment recoveries that were not included in PRG's recommended recovery calculations.

Finding 1 – Upward Adjustment of Proposed Lease Payment Recoveries Previously Calculated by PRG

For the eight lease files we reviewed, PRG calculated $363,800 of potential lease payment recoveries. However, based on our review of PRG's analysis and the associated lease files, we calculated potential lease payment recoveries of $514,874, or an additional $151,074. Please refer to Appendix B for details regarding our analysis.

PRG's analysis addressed lease payments made through either February 29 or March 31, 2008. In order to provide regional management with comparable results, we matched PRG's end date for each lease reviewed. Therefore, our potential lease payment recovery amounts are only calculated through PRG's ending dates. However, for four of the leases, overpayments have continued beyond PRG's end dates and will continue until the respective incorrect payments are adjusted.

Finding 2 – Overpayment of Real Estate Tax Escalation Adjustment For Lease Number LNJ23234

We found that GSA overpaid $6,882 of real estate taxes for lease number LNJ23234. This overpayment was not addressed by PRG. Details regarding this tax overpayment are discussed in Appendix C.

Recommendation

We recommend that the Director, Account Management Division, initiate prompt action to recoup overpayments that have been identified and/or verified for the eight leases we reviewed. Similarly, timely actions to verify and recoup proposed overpayments for the remaining leases reviewed by PRG should also be initiated.

Management Comments

Management asserted that corrective action has been taken on the reported overpayments. In addition, management provided an action plan to mitigate errors in the future. Refer to Appendix A for a copy of management's response.

Management Controls

A recovery audit is defined as a control activity designed to assure the integrity of contract payments, and as such, it is a management function and responsibility. Our audit objectives directly address and test the accuracy of this control.

The review was conducted during the period of June 2008 through January 2009 in accordance with generally accepted government auditing standards.

This report documents partial preliminary results that were conveyed to regional management on August 20, October 7 and October 8, 2008.

If you have any questions regarding this report, please contact me on (212) 264-8623 or Kyle Donaldson on (212) 264-8630.

STEVEN JURYSTA
Audit Manager
NY Field Audit Office (JA-2)

REVIEW OF PROPOSED LEASE PAYMENT RECOVERIES
NORTHEAST AND CARIBBEAN REGION
REPORT NUMBER A080179/P/2/R09003

MANAGEMENT COMMENTS

GSA

GSA Northeast and Caribbean Region

JUL 1 0 2009

MEMORANDUM FOR	HOWARD R. SCHENKER REGIONAL INSPECTOR GENERAL FOR AUDITING – JA-2
FROM	JOHN SCORCIA *John Scorcia* REGIONAL COMMISSIONER PUBLIC BUILDINGS SERVICE NORTHEAST AND CARIBBEAN REGION
SUBJECT	Draft Report: Review of Proposed Lease Payment Recoveries Northeast and Caribbean Region Report Number A080179

I have reviewed your report and have no comments. Please note that the Real Estate Acquisition Division (formerly known as Account Management Division) has taken corrective action on the overpayments reported, and has instituted an Action Plan to effect internal controls to mitigate errors in the future.

If you have any questions, please contact me at 212-264-4282.

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NORTHEAST AND CARIBBEAN REGION
REPORT NUMBER A080179/P/2/R09003

MANAGEMENT COMMENTS

REAL ESTATE ACQUISITION DIVISION
ACTION PLAN TO MITIGATE LEASE PAYMENT DISCREPANCIES
July 2009

A PRG audit performed in March and June of 2008 uncovered a number of instances where rentals paid to lessors were not in accordance with lease contracts, tax adjustment calculations were not performed due to lack of tax receipts, or CPI increases were not effected. There are a number of reasons for these discrepancies:

1. The decreased rental set forth in the lease or the supplemental lease agreement is not effected on the proper date due to lack of a system alert.

2. The CPI escalation is calculated incorrectly, or not calculated at all.

3. Real estate tax bills are not provided to the Government by the lessor as set forth in the lease.

4. Finance has made erroneous duplicate rental payments to the lessor.

In an effort to prevent these discrepancies from occurring in the future, Real Estate Acquisition has implemented the following Action Plan:

1. A one time effort will be made, during the summer of 2009 with the assistance of summer interns, to review all the lease documents in the inventory to capture those leases that contain step down rental provisions, or stepped rental increases, and to ensure that a STAR project is created for such actions. This will create an alert indicating that a 620 must be created on a date certain to effect the proper rental decrease/increase in a timely manner. This action will also allow for more precise BA53 budget action.
2. A tracking system will be created to ensure that lessors submit paid tax receipts in accordance with the lease contract provisions so that tax adjustments, whether increases or decreases, are performed in a timely manner.
3. Monthly review of the Negative Net Operating Income report; this report indicates discrepancies in revenue vs. expenses, and will provide timely alert when lease rental payments exceed revenue.
4. Each branch will be assigned a contract hire to maintain data integrity, such as the creation of project numbers for rental increases/decreases, calculation of tax adjustments and tracking of tax receipt submissions, timely CPI adjustments, etc.

The Division Director and Branch Chiefs will monitor the actions set forth in the plan and make adjustments where necessary.

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SUMMARY OF THE REVIEW OF PROPOSED LEASE PAYMENT RECOVERIES AND RELATED AUDIT ADJUSTMENTS

	PER CONSULTANT			PER AUDIT				
Lease Number	Lease Payments Made	Lease Payments Due	Proposed Recovery	Lease Payments Made	Lease Payments Due	Proposed Recovery	Audit Adjustments	Notes
	(A)	*(B)*	*(C)=(A)-(B)*	*(D)*	*(E)*	*(F)=(D)-(E)*	*(C) - (F)*	
LPR19069	$ 951,191	$ 945,468	$ 5,723	$ 951,074	$ 945,812	$ 5,262	$ 461	(1)
LPR19057	1,346,313	1,343,718	2,593	1,346,313	1,344,803	1,510	1,083	(2)
LNY23382	814,094	805,241	8,853	814,094	805,241	8,853	0	(3)
LNJ23234	583,388	579,808	3,580	588,269	588,514	(245)	3,825	(4)
LNY22901	4,673,090	4,669,181	3,909	4,673,071	4,673,087	0	3,909	(5)
LNY22885	83,966,565	83,733,677	232,888	83,966,567	83,565,738	400,829	(167,941)	(6)
LNY23333	1,099,478	1,081,157	18,321	1,099,478	1,081,157	18,321	0	(7)
LPR19030	1,488,401	1,400,469	87,933	1,488,401	1,408,057	80,344	7,589	(8)
TOTALS			$ 363,800			$ 514,874	$ (151,074)	

NOTES:

(1) The annual adjusted rent for this lease was scheduled to decrease from $175,056 to $164,464 on August 17, 2007, the start of the lease's sixth year (these amounts were derived by PRG and include PRG's calculation of accumulated CPI increases). PRG found, however, that GSA continued to pay rent at the old, higher rate even though the lease had entered its sixth year. PRG's analysis concluded that GSA had overpaid this lease by $5,723 through February 29, 2008.

We verified that GSA did start overpaying on this lease beginning in the sixth year as the annual rent was not reduced in accordance with lease terms. However, we calculated a proposed recovery amount of $5,262 through February 29, 2008. Our lower recovery amount is attributable to differences in calculating CPI adjustments; for example, PRG did not include a CPI escalation for the sixth year of the lease but we did.

PRG's review covered lease payments through February 29, 2008. Therefore, until the incorrect monthly lease payment is adjusted, overpayments will continue. GSA is paying $14,588 per month; we calculate a monthly rental of $13,818. Hence, the continuing monthly overpayment totals $770.

(2) The annual adjusted rent for this lease was scheduled to decrease from $248,748 to $243,562 on October 1, 2007, the start of the lease's sixth year (these amounts were derived by PRG and include PRG's calculation of accumulated CPI increases). PRG found, however, that GSA continued to pay rent at the old, higher rate even though the lease had entered its sixth year. PRG's analysis concluded that GSA had overpaid this lease by $2,593 through March 31, 2008.

SUMMARY OF THE REVIEW OF PROPOSED LEASE PAYMENT RECOVERIES AND RELATED AUDIT ADJUSTMENTS (CONTINUED)

NOTES:

(2) We verified that GSA did start overpaying on this lease beginning in the sixth year as the annual rent was not reduced in accordance with lease terms. However, we calculated a proposed recovery amount of $1,510 through March 31, 2008. Our lower recovery amount is attributable to differences in calculating CPI adjustments; PRG did not include a CPI escalation for the sixth year of the lease but we did.

PRG's review covered lease payments through March 31, 2008. Therefore, until the incorrect monthly lease payment is adjusted, overpayments will continue. GSA is paying $20,729 per month; we calculate a monthly rental of $20,478. Hence, the monthly overpayment totals $251.

(3) Under terms of this lease, the government was to benefit from a rent-free period from July 10, 2006 through January 9, 2007 with rental payments to commence as of January 10, 2007. PRG found that GSA made an additional rent payment of $8,853 on February 8, 2007 to apparently compensate the landlord for four additional days: January 6 through January 9, 2007 (PRG believes that because January 6, 2007 is 180 days after July 10, 2006, the effective date of the lease, this payment was erroneously calculated). However, since lease payments were supposed to commence six months after the effective date of the lease (i.e. January 10, 2007), this extra payment should not have been made.

We agree with PRG's conclusion. Our analysis shows that all rental payments that were required to be made as of January 10, 2007 were fully accounted for. Therefore, the additional $8,853 payment that was made on February 8, 2007 was unnecessary and should be recovered.

(4) The annual adjusted rent for this lease was scheduled to decrease from $108,561 to $100,805 on November 1, 2007, the start of the lease's sixth year (these amounts were derived by PRG and include PRG's calculation of accumulated CPI increases). PRG found, however, that GSA continued to pay rent at the old, higher rate even though the lease had entered its sixth year. PRG's analysis concluded that GSA had overpaid this lease by $3,580 through March 31, 2008.

We verified that GSA did start overpaying on this lease beginning in the sixth year as the annual rent was not reduced in accordance with lease terms. However, we noted that a reduced lease payment was processed on May 1, 2008 that appears to have been designed to recoup prior month's overpayments[1] – PRG's analysis did not include this payment. After accounting for this payment and reapplying corrected CPI factors (we used CPI factors that

[1] We were not able to verify the purpose of the reduced payment or obtain the actual calculation. However, unless additional information comes to light, we will assume that the reduction in the monthly lease payment was made in order to recoup the previous five months worth of overpayments.

SUMMARY OF THE REVIEW OF PROPOSED LEASE PAYMENT RECOVERIES AND RELATED AUDIT ADJUSTMENTS (CONTINUED)

NOTES:

(4) correspond to the commencement month of the lease (Nov), not the month prior (Oct), as stipulated in this lease's escalation clause), we conclude that GSA may have actually *underpaid* for this lease by $245.

(5) Citing Supplemental Lease Agreement No.2 (SLA), PRG determined that the total escalated annual base rent should have increased from $430,602 to $432,323 for the lease's extension period (April 1, 2007 thru March 31, 2008). However, starting April 1, 2007, GSA increased the annual rent to $436,232. As a result, PRG concluded that GSA is overpaying by $325.11 per month, resulting in a total proposed lease payment recovery of $3,909.

However, the SLA referred to by the consultant was later modified. As outlined in Digest Action Number 19, as well as SLA No. 2, the total annual base rent increased from $430,602 to $436,232 for the extension period (April 1, 2007 thru March 31, 2008). This agrees with what GSA was paying. Therefore, we determined that there is no overpayment associated with this lease.

(6) PRG's analysis concluded that GSA overpaid Lease Number LNY22885 by $232,888 from October 20, 2002 through November 30, 2005. According to PRG's report, "effective June 1, 2002, paragraph 2 of SLA 21 increases annual rent by $24,950, from $9,913,911 to $9,938,861, to reflect the additional operating costs associated with repair and maintenance of items specified in paragraph 1 of SLA 21. The base operating cost is also increased by $24,950, from $1,219,000 to $1,243,950. Digest Action 7 correctly increases the operating rent from $1,293,749 to $1,318,699 to account for the $24,950 increase in operating costs. The problem arises when Digest Action 8 increases rent by $92,848 for the 10/20/2002 operating cost adjustment. The operating rent only increased from $1,318,699 to $1,336,848, an increase of $18,149, therefore the operating cost adjustment should have been processed for $18,149, rather than $92,848." *Effectively, the entire cumulative operating cost increase was added to the previous year's total adjusted rent, rather than just the incremental increase*. As a result, GSA overpaid by $74,749 per year ($92,848 - $18,149) for the affected period.

We agree with PRG's conclusion regarding the period from October 20, 2002 through November 30, 2005. However, our analysis shows an additional error in this lease's rental calculation that has continued beyond November 30, 2005 and results in additional potential overpayments. Specifically, as a further consequence of the error reported by PRG, the base annual rental associated with this lease was increased by $74,749 on the CPI Escalation worksheet that was prepared for the lease year beginning on October 20, 2002. The following document excerpts illustrate this fact:

NOTES:

(6)

III. a. Gross Annual Rent in basic lease contract (6a of initial 387)	=	9,839,162.00 ✓
b. Total annual increase in operating cost (II.c.)	=	74,749.08
c. New escalated Gross Annual Rent (a+b)	=	**$9,913,911.08** ✓
IV. a. Service & utils. In 6B of initial 387 for the base contract	=	1,219,000.00
b. Total annual increase in services & utilities cost (ii.b.)	=	74,749.08
c. New escalated cost of service & utilities (a+b)	=	1,293,749.08 ✓
V. a. Net Annual Rental in 6c of initial 387 for basic lease contract	=	$\boxed{8,620,162.00}$
b. Total annual increase in insurance cost (ii.a.)	=	N/A
c. New Net Annual Rental Cost (a+b)	=	8,620,162.00 ✓
Old / Current Rent = **$9,881,339.40**	***Increase in Rent*** =	**$32,571.68**

CPI Escalation Worksheet Dated 12/6/01 for the Lease Period 10/20/01 to 10/19/02

III. a. Gross Annual Rent in basic lease contract (6a of initial 387)	=	9,938,861.08 ✓
b. Total annual increase in operating cost (II.c.)	=	92,898.19
c. New escalated Gross Annual Rent (a+b)	=	**$10,031,759.27** ✓
IV. a. Service & utils. In 6B of initial 387 for the base contract	=	1,243,950.00
b. Total annual increase in services & utilities cost (ii.b.)	=	92,898.19
c. New escalated cost of service & utilities (a+b)	=	1,336,848.19 ✓
V. a. Net Annual Rental in 6c of initial 387 for basic lease contract	=	$\boxed{8,694,911.08}$ ✓
b. Total annual increase in insurance cost (ii.a.)	=	N/A
c. New Net Annual Rental Cost (a+b)	=	8,694,911.08 ✓
Old / Current Rent = **$9,938,861.08**	***Increase in Rent*** =	**$92,898.19**

CPI Escalation Worksheet Dated 10/29/02 for the Lease Period 10/20/02 to 10/19/03

Note that the base rent should have remained the same from 01/02 to 02/03; there was no reason for it to have changed. The fact that the increase equals $74,749, the amount by which operating costs were overstated, indicates that both errors are interrelated.

SUMMARY OF THE REVIEW OF PROPOSED LEASE PAYMENT RECOVERIES AND RELATED AUDIT ADJUSTMENTS (CONTINUED)

NOTES:

(6) This erroneous adjustment to the base rent adversely impacted the annual rent calculation beginning on December 1, 2005. SLA 25 established a new annual rental amount of $10,343,701 for December 2005 and $10,194,661 for the period of January 1, 2006 through October 19, 2019. SLA 25 also reset the base cost of services to $1,499,749 as of December 1, 2005. These numbers incorporate the erroneous base rent, as follows:

	December 2005*	1/1/2006 to 10/19/2019
Annual Rental	$10,343,701	$10,194,660
Base Cost of Services	1,499,749	1,499,749
Effective Base Rent	$ 8,843,952	$ 8,694,911

**SLA 25 added an additional $149,041 to the rent in 12/05 without explanation*

As previously stated, the lease's base rent should be $8,620,162. Consequently, as of December 1, 2005, GSA has continued to overpay this lease by $74,749 per year. This equates to audited total potential recoveries of $400,829 for this lease (through February 29, 2008, PRG's review period).

Overpayments will continue until the incorrect annual lease payment is adjusted. GSA is paying $857,626 per month; we calculate a monthly rental of $851,397. Hence, the monthly overpayment totals $6,229.

(7) The annual adjusted rent for this lease was scheduled to decrease from $407,697 to $256,242 on November 1, 2007, in accordance with SLA 2. PRG found, however, that GSA continued to pay rent at the old, higher rate through December 14, 2007. PRG's analysis concluded that GSA had overpaid this lease by $18,321.

We agree with PRG's conclusion. The proposed lease payment recovery of $18,321 is accurate.

(8) PRG's analysis concluded that GSA overpaid lease number LNY19030 by $87,933, as follows:

(a) Per SLA 5, paragraph 2(b), for the period of December 18, 2000 thru December 31, 2000, GSA underpaid the lessor by $3,972 – annual rental of $194,149 was due, GSA only paid based on an annual rental of $88,610.

SUMMARY OF THE REVIEW OF PROPOSED LEASE PAYMENT RECOVERIES AND RELATED AUDIT ADJUSTMENTS (CONTINUED)

NOTES:

(8) (b) Per SLA 5, paragraph 2(c), for the period of January 1, 2001 through September 30, 2001, GSA overpaid the lessor by $923 – annual rental of $275,463 was due, GSA paid based on an annual rental of $276,693.

(c) Based on SLA 4, PRG derived an annual rental (inclusive of CPI increases) of $153,335 for the period beginning November 10, 2005. PRG found that GSA has been paying this lease based on an annual rental of $196,606. Therefore, PRG concluded that GSA has overpaid this lease by $90,982 for the period of November 10, 2005 thru March 31, 2008.

We verified that GSA did overpay on this lease. However, we calculated a proposed lease recovery amount of $80,344 through March 31, 2008. Our lower recovery amount is attributable to differences in calculating CPI adjustments; PRG did not include any additional CPI escalation adjustments after November 10, 2005 but we did.

PRG's review covered lease payments through March 31, 2008. Therefore, until the incorrect monthly lease payment is adjusted, overpayments will continue. GSA is paying $16,384 per month; we calculate a monthly rental of $13,703. Hence, the monthly overpayment totals $2,681.

REVIEW OF PROPOSED LEASE PAYMENT RECOVERIES
NORTHEAST AND CARIBBEAN REGION
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SUMMARY OF REAL ESTATE TAX OVERPAYMENT
FOR LEASE NUMBER LNJ23234

	TAX ESCALATION AS CALCULATED AND PAID BY GSA (1)					TAX ESCALATION AS RECALCULATED BY OIG							
						Allocation of Annual Real Estate Taxes			Base Year RE Taxes				
Tax Year	Total Taxes	Base Year Taxes	Increase	% of Govt Occupancy	Tax Escalation Paid	Total Taxes	5-Story Office Bldg. Allocation	Sheraton Hotel Allocation	Base Year Taxes	5-Story Office Bldg. Allocation	Difference	Tax Escalation Due	Audit Adjustment
	(A)	*(B)*	*(A)-(B)=(C)*	*(D)*	*(C)x(D)=(E)*		*(F)*		*(G)*	*(G)x 45%=(H)*	*(F)-(H)=(I)*	*(I)x(D)=(J)*	*(E) – (J)*
	(2)	(3)		(1)		(2)	(4)	(4)	(3)	(5)			(6)
2007	$1,110,294	$909,324	$200,970	0.02521	$5,066	$1,110,294	$506,082	$604,212	$909,324	$409,196	$96,886	$2,443	
2006	1,089,378	909,324	180,054	0.02521	4,539	1,089,378	490,220	599,158	909,324	409,196	81,024	2,043	
2005	1,036,450	909,324	127,126	0.02521	3,205	1,036,450	466,403	570,048	909,324	409,196	57,207	1,442	
					$12,810							$5,928	$6,882

NOTES:

(1) Under lease number LNJ23234, the government leases 3,615 rentable square feet (RSF) of office space on the second floor of Woodbridge Place, located at 517 Route One South, Iselin, NJ. The lease terms provide for an annual real estate tax escalation, based on the government's share of any increase in real estate taxes during the lease term over the amount established as the base year (i.e., 2002) tax. For this purpose, the Government's percentage of occupancy is 2.521 percent based upon an occupancy of 3,615 RSF in a building of 143,395 RSF. Finally, the block and lot identifiers for this building are Block 369, Lot 100B.

SUMMARY OF REAL ESTATE TAX OVERPAYMENT FOR LEASE NUMBER LNJ23234 (CONTINUED)

NOTES:

(2) The real estate tax bills submitted by the lessor for 2005 and 2006 reference Block 369, Lot 100B and show total taxes paid of $1,036,450 and $1,089,378, respectively. However, the bills also describe the property as being a Sheraton hotel with a total assessed value of approximately $15.6 million. In addition, the bills contain handwritten notations that allocate the taxes paid between the hotel and an office building.

We searched NJ real estate tax records and found that Lot 100B was subdivided into two lots in 2007: Lot 100.021 contains the five story office building (assessed value of $6.9 million) and Lot 100.02 contains the Sheraton hotel (assessed value of $8.2 million).

Consequently, for 2007, the real estate tax bill submitted by the lessor references Block 369, Lot 100.021 and shows total taxes paid of $506,082. For this year, however, the bills describe the property as being a five story office building with an assessed value of approximately $6.9 million. To arrive at total 2007 taxes of $1,110,294, the lessor added another $604,212 that was associated with Block 369, Lot 100.02, the Sheraton property.

(3) The lease was entered into on July 3, 2002. Accordingly, the base year real estate taxes represent all the real estate taxes paid in 2002.

(4) It is clear from the information delineated in note (2) that the real estate tax escalation calculation submitted by the lessor and approved by GSA was based on real estate taxes assessed for both properties: the office building as well as the hotel. This is not consistent with various terms of the lease:

a. According to paragraph 1.7(A), for purposes of tax adjustments, "real estate taxes… are only those taxes which are assessed against the building and/or the land upon which the building is located, without regard to benefit to the property, for the purpose of funding general Government services." The referenced 'building' is the office building, as described on the first page of the lease. Therefore, the only taxes that are subject to an escalation adjustment are those taxes attributable to the office building.

b. According to paragraph 1.7(F), "the Government shall pay its share of tax increases…based on the ratio of the rentable square feet occupied by the Government to the total rentable square feet in the building…For the purpose of this lease, the Government's percentage of occupancy…is 2.521 percent based upon a occupancy of 3,615 rentable square feet in a building of 143,395 rentable square feet…" In

SUMMARY OF REAL ESTATE TAX OVERPAYMENT
FOR LEASE NUMBER LNJ23234
(CONTINUED)

NOTES:

(4) b. order to properly allocate the real estate taxes associated with both buildings in accordance with this clause, the percentage of occupancy should have been based on the combined RSF of both buildings. *However, the referenced 143,395 RSF only encompasses the office building.* Therefore, the calculated percentage of occupancy should only be applied to real estate taxes attributable to the office building.

In order to correct the tax escalation calculation, we derived the real estate taxes attributable to the office building for each affected year. Since the office building was assigned to its own Lot in 2007, the $506,082 represents the actual 2007 tax assessment attributable to the office building. For 2005 and 2006, we allocated the total taxes paid for both buildings based on a ratio of their respective assessed values. Consequently, we determined that 45% of the total taxes were attributable to the office building ($6.9 million ÷ $15.1 million ≈ 45%).

(5) As indicated in note (3), for purposes of the tax escalation clause, base year taxes were originally derived by aggregating all taxes paid in 2002. However, since this amount included taxes assessed for both buildings, the base year amount must be corrected to only include taxes attributable to the office building. Consequently, using the ratio derived in note (4), we recalculated base year taxes to be $409,196 ($909,324 x 45%).

(6) Based on our analysis, GSA overpaid real estate taxes by $6,882 and should seek reimbursement from the lessor. Finally, GSA should ensure that the appropriate allocation base is used when calculating future tax escalation adjustments.

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Deputy Assistant Inspector General for Real Property Audits (JA-R)	1
Director, Internal Control and Audit Division (BEI)	1
Special Agent in Charge (JI-2)	1