



**STATE OF WASHINGTON  
DEPARTMENT OF REVENUE**

**Personal and Industrial Property Valuation Guidelines –  
Trended Investment Method  
for  
January 1, 2007**

**If You Have Questions**

Direct questions regarding these *Guidelines* or other personal property and industrial property tax issues to:

<b>Name</b>	<b>Title</b>	<b>Phone Number</b>	<b>E-Mail Address</b>
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The 2007 Personal Property and Industrial Valuation Guidelines are posted on the Department's web site at [www.dor.wa.gov](http://www.dor.wa.gov).

Access the Valuation Guidelines by clicking the **Taxes** tab at the top of the screen, on **Property** on the left-hand side of the screen under Taxes, and then on **Publications**. Choose the **Personal Property and Industrial Valuation Guidelines**, and select **2007**.

# SPACE IMPROVEMENTS (LEASEHOLD IMPROVEMENTS)

## PERSONAL PROPERTY OR REAL PROPERTY?

### **Leasehold improvements may be real or personal property, depending on a number of factors.**

Trade fixtures on land owned by the person who owns the improvements may be classified as real property, but on leased land, the same improvements are personal property.

- **TRADE FIXTURES** – Articles placed in or attached to rented buildings by a tenant to help carry out the trade or business of the tenant are generally regarded as trade fixtures. For example, a tenant's shelves used to display merchandise are trade fixtures and retain the character of personal property, as opposed to all other fixtures that were but are no longer personal property when they are attached to and become part of the real estate. Despite the consensus on the concept of trade fixtures in general, applicable law and custom govern when a specific item is a trade fixture in a particular assignment (**USPAP, 2002 ed.**). Also called chattel fixture.

This concept, which is peculiar to the landlord-tenant relationship, refers to the machinery or equipment of any commercial or industrial business which operates on leased land or in rented quarters. Such machinery or equipment is a trade fixture; i.e., the tenant's personal property, no matter how firmly it may be attached to the landlord's realty, unless it could not be removed without virtually destroying the building housing it, or otherwise seriously damaging the landlord's realty. Brown on *Personal Property* (2d Edition 1955), Sec. 144. ([WAC 458-12-005\(9\)](#).)

### **Leased building space**

- 1. Q.** When valuing leasehold improvements (LHI) such as retail tenant improvements located at a shopping mall or strip center for purposes of property taxation, is it proper to value the tenant installed improvements (TIs) as personal property?
  - A.** Yes. These improvements will appear on the tenant's depreciation schedule and add value to the business enterprise.
- 2. Q.** What if the landlord installed the improvements and billed the tenant an extra amount to recover the cost over the term of the lease?
  - A.** While these improvements add value to the business enterprise, they do not appear on the tenant's depreciation schedule—but they could. These are capital improvements, and the increase in tenant occupancy cost is essentially a financing agreement, not additional rent. In most cases, these assets should be valued as personal property of the landlord. However, if the income approach is used to value the real property and the additional rent for TIs is included and valued, then they may be valued as real property. TIs should always be valued as personal property unless it is clear they are valued as real property.
- 3. Q.** What if the LHI are walls, plumbing, and electrical; aren't those improvements automatically real property?
  - A.** When improvements are permanently affixed to the real estate, they may appear to be real property. However, the value of the property rights associated with the improvements is what must be determined. The value of LHI is taxable, the question is whom do those improvements benefit and give value. In nearly every situation, the answer is that the tenant is the sole beneficiary of the value of these improvements. It doesn't matter if they are classified as real or personal property but in nearly every case it is the tenant who benefits and thus the LHI value is personal property. If the landlord installed the LHI then the landlord should be assessed for the value of the LHI as personal property. These improvements are seldom assessed as part of the real property. However, if it is certain that the value associated with the LHI is assessed as real property it should not be assessed as personal property.
- 4. Q.** What if the tenant has a lease term that is shorter than the life of the assets?
  - A.** When the term of the lease is less than the life of the assets it is important to consider if it is likely the tenant will renew the lease or remain as a tenant. If there is no requirement that the tenant vacate the premises, the LHI must be assessed as personal property. However, if the tenant has given notice or received notice to vacate the effect on

value must be considered. Nevertheless, the value of the property rights associated with the LHI are personal property unless it is clear the property is assessed as real property.

5. **Q.** If the tenant leases a shell and finishes the space but is required by the lease to leave any tenant improvements in place when the lease expires, are the TIs personal property? What if at the end of the lease these improvements will be removed by the landlord before the next tenant leases the space?
  - A. Yes. The tenant improvements are personal property if the tenant is required to remove them at the end of the lease. If the landlord requires that the TIs be left but rarely if ever re-leases the space without removing the former tenant's TIs, they are still personal property since there is no likely benefit to the landlord. These improvements may even be considered a detriment to the real property since it will cost both time and money for the landlord to remove the improvements. Landlords often require the TIs be left so that the demolition and build out for the new tenant can be in the landlord's control, minimizing the overall time and expense to re-tenant the space. Nevertheless, if the TIs are included in the real property assessment of the property, they should not be assessed as personal property.
6. **Q.** Are leasehold improvements permanently affixed to a building real property even if the life of the asset is shorter than the length of the lease?
  - A. No. This is personal property; the issue is whether it is personal property of the tenant or of the landlord.
7. **Q.** What if the TIs are trade fixtures?
  - A. Trade fixtures are defined in WAC as personal property so they are always personal property when owned or installed by or on behalf of the tenant.
8. **Q.** What if improvements are unique to the tenant's business?
  - A. Unique TIs, even if installed by the landlord as part of the lease agreement are personal property, the benefit is only to the business enterprise even though there may be financial benefit to the landlord in terms of rent received. If the income approach is used to value the real property and additional rent for TIs are included and valued then they may be valued as real property. However, TIs should always be valued as personal property unless it is clear they are valued as real property.
9. **Q.** If the landlord installed the tenant improvements and charges market rent for finished retail space, are the improvements to finish the space (TIs) real property?
  - A. If the value of the TIs is captured in the real property appraisal, they are real property. However, it is better to assess these improvements as personal property in most instances because the economic life of these assets is not consistent with the life of the real estate; for example, carpeting may have only a 5-year life while the real estate has a life of 25 plus years. Valuing carpeting and other short-lived assets using a real property income approach can overvalue the property because real property has a much longer life than these assets. A significant component of the capitalization rate recaptures the investment based on its life so that capitalized rent associated with an abundance of shorter-lived assets could overstate the value of those assets by three or four times. Net income from TI rent of \$1,000 at a recapture rate of 20% translates into \$5,000, but at 4%, it is \$25,000. However, in markets where landlord-installed TIs are typical and are reflected in capitalization rates and other market units of comparison, real property assessment is reasonable and accurate even when rent associated with these short-lived assets is included. High-rise office buildings are often leased as finished space, while retail space is rarely leased this way in most markets.
10. **Q.** To ensure all taxable property (property rights) is assessed and taxed, what is the best procedure or procedures and policies to follow giving significant weight to ease of administration for both taxpayer and tax administrator?
  - A. Avoiding omitted property assessment is a top priority while double assessment is less critical. Focus on ensuring that the value of all property rights is captured, not on what asset is real property and what asset is personal property; the assignment is to value the property rights associated with the tangible assets.

Common policies and procedures for discovery and assessment of both real and personal property must be in place to coordinate efforts, avoid omissions, and limit double assessment as much as possible. Real property appraisers' valuation methods and procedures must be communicated to personal property appraisers and vice versa, especially those affecting the assessment of leasehold improvements.

As a general rule, list and value all leasehold improvements as personal property: if owned by the landlord, assess them to the landlord's personal property account; if listed by the business, include them in the business account assessment. Establish a process for making corrections that minimize taxpayer and staff time when double assessments are confirmed.