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CORPORATE REAL ESTATE SOLUTIONS

7 Indicators That You Need to Audit Your Office Lease

Few areas hold as much impact on capital outlay as real estate and leasehold expenses. Ensuring that your company is not overpaying is integral to fiscal management. You know an audit is in order when you see:

SIGNIFICANT JUMPS IN OPERATING EXPENSES / ADDITIONAL RENT

Performing a simple trend analysis of your year-to-year operating expense obligation is a must. While inflationary and market forces generally create an escalating building operating expense profile, a marked jump in expenses issued to you should raise a red flag. Causes of significant jumps might include new and potentially lease impermissible capital projects, new expense categories not reflected in your base year, new contracts or vendor changes, and newly increased or above standard services which are not reflected in your base year.

CHANGE IN PROPERTY OWNERSHIP / PROPERTY MANAGER

A change in property ownership or property management should always trigger a lease audit. Property management changes create a very real risk of affecting accounting category integrity which is integral to an apples to apples comparison to your base year expenses. Management fee levels and composition, related party vendors, and changing service levels are also common building operating expense issues when a building changes ownership or management. Another potential trap in a building transaction is the tenant estoppel which, if not carefully worded, has the potential to sign away rights and leverage. Finally, once a building changes hands, future audit finds and recoveries may become complicated should overcharges be identified in years under previous ownership.

BUILDING UNDERGOING CAPITAL IMPROVEMENTS OR RENOVATIONS

Renovations and capital projects may be subject to your lease operating expenses or capital expense exclusions, and every project should be audited for permissibility under your lease. While you are most likely to reimburse the landlord for a true operating cost, you should not be obligated to reimburse your landlord for a capital expense project if it does not legitimately reduce building operating costs in the future. If your building has undergone renovations and/or capital improvements in past, yet unaudited years, it may not be too late. Those costs were most likely amortized across future years, and there may still be an opportunity for avoiding ongoing expenses if they prove to be impermissible per your lease exclusions.

YOUR LEASE IS COMMENCING / EXPIRING

Perhaps the most opportune and important times to have a lease audit performed are at the commencement and expiration of your lease. If you occupy under a "base year" lease structure, the valuation of your base year will have material impact on your lease hold expenses throughout the term of the lease. It is in your direct interest to both validate all charges in year one, and to validate expense levels so as to not undervalue your base year. Likewise, lease audits should always be performed as a standard practice at any lease expiration. Not only might you lose rights to recoup any overcharges after vacating the premises (audit window), you may lose significant leverages after you move out. Lease audits and the potential uncovering of over-or mischarges may also have a material impact on any lease renewal negotiations and construction of lease amendment / renewal language.

SIGNIFICANT SHIFTS IN BUILDING OCCUPANCY LEVELS

Accounting for accurate building occupancy levels is integral to an accurate "gross up" methodology and can have enormous implications to your operating expense obligation. This can be significantly magnified vis-à-vis fixed versus variable occupancy level driven expenses should the vacancy rate in your building be sizeable. And of course it directly benefits the fiscally conscious tenant to ensure that occupancy shifts are accurately reflected within a given expense period.

NO OR LIMITED BACKUP SUPPLIED TO ANNUAL RECONCILIATION STATEMENTS

Just as you would not accept your credit card statement if they did not itemize your charges, accepting an annual reconciliation on face value is fiscally unwise. Year-end reconciliations can carry significant and long term financial impact – particularly if your lease terms include caps or index – derived escalators. Failure to timely challenge a landlord's computations and/or inclusions may forfeit your rights thereafter per audit windows as discussed above. Accepting a rudimentary reconciliation, even one broken down to expenses per billing category is to trust your company's finances to an outside party with a vested interest in maximizing its ROI. Whenever an annual reconciliation crosses your real estate department's desk without sufficient back up to verify expenses and calculations, a lease audit should automatically be triggered.

LANDLORD IS IN FINANCIAL STRAITS

While it might not always be obvious, it is in a tenant's best interests to periodically inquire into a building and its owner's financial well-being. Acclaim has uncovered multiple examples of landlords in difficult financial straits materially overcharging their tenants. And while we would never suggest that such a situation directly underlies the overcharge in any specific example, the coinciding of the two – a landlord in financial distress and overcharges to its tenants – can be a recurring theme. It is important to remember that auditing your landlord issued expenses is your right. It is sound fiscal practice and required compliance protocol in many of the most efficiently run companies in the world.

Are any of these indicators happening at your building?
Call Mike for a call for a free consultation.

Mike Maroon, SIOR is the Managing Partner of The Acclaim Group, a leading real estate adviser to corporations locally, nationally and globally.