P. Stevens Associates, Inc. (PSA)
Case Study #1
Base Year Audit Generates Enormous Savings For Tenant

Project Outline

A tenant leased 170,000 square feet in a newly completed 300,000 square foot office building, owned by a local developer. During the second year of the lease, the tenant received a statement from the owner with the computation of the base year expenses. Recognizing the importance of establishing a proper base year, the tenant engaged PSA to do a base year audit.

PSA Added Value

The audit confirmed that the owner had grossly understated the amount for base year real estate taxes. The lease defined base year taxes as the amount of taxes, which would be paid during the first fiscal year that the building was "fully assessed as a completed structure". The owner interpreted this to mean that the base year taxes would be the taxes for the first fiscal year that the building was a "completed structure". The building structure was completed during fiscal year 2004, thus the owner contended that the fiscal year 2004 tax amount of $653,000 was the base year. However, a review of the City Assessor records for fiscal year 2004 revealed that the assessor had given the owner a 24% discount in the assessed value. This discount was provided since the building, although being a completed structure, was not fully rent producing. The discount in the assessed value also equated to a like discount in the actual taxes paid. PSA contended that the tax base year must be fiscal year 2005, the first year that the building would be fully assessed.

PSA Results

The owner conceded to the case made by PSA with one change. Rather than using fiscal year 2005, the base year was re-established as the amount of taxes, which would have been paid in fiscal year 2004, had the assessor not given the 24% discount. PSA successfully reset the base year amount at $888,000. Increasing the tax base year by $235,000 generates an annual saving to the tenant of $133,000 and $1,463,000 over the lease term.

Total Savings: $1,463,000

P. Stevens Associates, Inc. (PSA)
Case Study #2
Current Year Lease Audit Opens Door To Base Year Expense Audit

Project Outline

A tenant leased 142,000 square feet of a 200,000 square foot office building, owned by an institutional investor. The tenant suspected that the operating expense escalations being passed through to them were high, as they had grown by 11% during their second lease year. Despite independent discussions with ownership, the tenant became frustrated with the lack of response and engaged PSA as they realized that an independent, experienced lease auditor would best serve their interests.

PSA Added Value

The preliminary audit revealed nominal overcharges by the owner during the second lease year, but more importantly, highlighted the fact that the base year expenses had been understated. Therefore, PSA desired to complete an in-depth audit of the base year operating expenses. The owner attempted to nullify the tenant's right to audit the base year since the time frame for that audit had passed. PSA argued that the current year audit must include an audit of the base year, since establishing the base year amount is integral to determining how much the tenant will pay in escalations during all years, subsequent to the base year. Consequently, the owner relented and agreed to deliver support documentation necessary to proceed with both the current year and base year audits.

The landlord had made numerous errors in calculating the base year expense amount.. These included:

- conflicting gross-up percentages of both 95% and 100%
- no gross-up of cleaning contract expense
- no provision for the cost of the cafeteria subsidy
- improper amortization of an Energy Management System
- understating the cost of management personnel allocated to the building
- overcharging the tenant for electricity for lights and plugs, thus disregarding specific lease provisions related to this

PSA Results

PSA's negotiations, on behalf of the tenant, resulted in increasing the base year operating expenses, thereby mitigating the tenant's operating expense increases over the entire lease term. The tenant received an immediate reimbursement of $60,000, and reaped a total savings of $214,000 over the lease term. PSA was also successful in helping the tenant reduce the tenant electricity cost, both retroactively and prospectively. This resulted in an immediate reimbursement of $50,000, and saved the tenant a total of $90,000 over the term.

Total Savings: $304,000.

P. Stevens Associates, Inc. (PSA)
Case Study #3
Lease Audit Creates Leverage For A Tenant When Property Is Being Sold

Project Outline

A tenant leased approximately 70,000 square feet of the space in a 750,000 square foot office Building, owned by an institutional investor. As part of its' fiduciary responsibilities to stockholders, the tenant opted to have the operating expenses audited. The building was under agreement to be sold, and was in the early stages of the due diligence process.

PSA Added Value

PSA explained how an audit would identify any potential overcharges and create leverage for the tenant, as a prospective buyer of the property would require an estoppel certificate from a major tenant of this size. The audit revealed three major areas of concern where the owner:

- overcharged the tenant for expensive building amenities, which per the lease were an owner's expense
- overcharged the tenant for the rental of the management office at twice the market rate
- billed the tenant for external audit and tax preparation fees required by ownership agreement documents

PSA Results

PSA identified nearly $186,000 in expenses to the property not permitted by the lease. The tenant received an immediate reimbursement of approximately $16,000 for the year in question. More importantly, the tenant added language to the estoppel concerning these specific audit findings, so that the new owner would not charge them for these expenses during the remaining six years of the lease, thus saving them an additional $96,000.

Total Savings: $112,000

P. Stevens Associates, Inc. (PSA)
Case Study #4
Lease Audit Provides Leverage For Tenant During Lease Renewal Negotiations

Project Outline

A tenant, which leased 20,000 square feet in a 120,000 square foot office building, was in the last year of its lease. Although content with the building and its location, the tenant had concerns about operating escalations paid during its tenancy. The tenant decided to engage PSA for a lease audit, as operating expenses had grown at a 12% compounded rate during the lease term. Gathering the necessary operating information and analyzing it would help them to either re-structure the lease at the current location, or compel them to re-locate to another building.

PSA Added Value

Completing a review of the lease and the previous year's escalation billings revealed one key point. The landlord had not:

- provided a "gross-up" clause in the lease for occupancy related expenses, although this was considered a standard in the leasing market at that time

The tenant had been paying extraordinarily high escalations because the base year expenses had been based on a building which was 50% occupied. Since there was no gross-up provision in the lease, expenses such as cleaning, rubbish removal and management fees were substantially lower when establishing the base year than in subsequent years when the building was near full occupancy. Based on the lease, the landlord was billing the tenant appropriately. However, PSA argued that had the "gross-up" clause been inserted in the lease, the tenant would have paid substantially less in rent escalation payments over the lease term. Further, the landlord had provided this "gross up" language in other leases in the building.

PSA Results

PSA recalculated base year expenses, assuming a 100% "gross up" and then recalculated what the escalation payments would have been during the lease term with this adjustment to the base year. The result of the recalculation for this 20,000 square foot tenant indicated a reduction in operating escalation payments of $70,000 during years 2-4, plus an additional saving of $25,000 for year 5 of its' lease. Armed with the PSA audit, the tenant successfully negotiated a lease re-structure and extension, including a retroactive adjustment of $95,000 for escalations. In addition, the gross-up clause was inserted into the newly re-structured lease.

Total Savings: $95,000

P. Stevens Associates, Inc. (PSA)
Case Study #5
Net Lease Tenant Finds Value In Lease Audit

Project Outline

A tenant leased 45,000 square feet, in 1,200,000 square foot office property, owned by a local developer. The tenant believed it was paying too much in operating escalations compared to the local market. The tenant also questioned an excessive level of services provided to the building, and even the necessity for some of these. Because they had a net lease, the company was unsure of what might be done, as a net lease provides that a tenant pays its proportionate share of all operating expense and real estate taxes as a "pass-through".

PSA Added Value

Despite the net lease arrangement, the lease provided that all "reasonable" expenses incurred in the operation and maintenance of the building would be "passed-through". This language was crucial, as the audit identified numerous operating expenses paid by the tenant, which were grossly in excess of those operating expenses observed in competitive buildings in the market. Those expenses included:

- security
- landscaping
- seasonal decorations
- amortization of capital improvements
- salaries for leasing personnel
- severance pay for a leasing agent

PSA successfully identified approximately $84,000 in overcharges and engaged the landlord in reducing these costs.

PSA Results

The landlord agreed to mitigate the overcharges through a reduction in the tenant's rent going forward. In addition, the lease was re-structured as a "gross" lease and the appropriate lease clauses were inserted to protect the tenant from further overcharges.

Total Savings: $84,000

P. Stevens Associates, Inc. (PSA)
Case Study #6
Base Year Audit Reveals Landlord Over-billings In Rehab Building

Project Outline

A tenant leased 15,000 square feet of space in a 75,000 square foot office building, which had undergone a complete “gut rehab” by a local owner. The tenant’s base year for operating expenses was calendar year 2002. In early 2003 the tenant received an estimate of operating expenses for 2003 reflecting an increase of 24% over the base year. Given this substantial increase, the tenant decided to engage PSA to validate this increase.

PSA Added Value

Having previously done audits in rehabbed buildings, PSA was very familiar with what occurred. The audit revealed that the owner had understated the base year expenses. During the rehab, extensive work had been done on the HVAC systems and elevators. These systems were protected by one-year warranties and included a provision where the owner was required to pay no maintenance expenses during the first year of operation. Hence, after the warranty period had expired the owner would have to pay for normal maintenance charges, and consequently, pass through any increases dictated by the lease. Since the warranty period coincided with the tenant’s base year, the tenant’s base year did not include any cost for the maintenance of the HVAC systems and the elevators. Therefore the owner had artificially understating operating expenses for the building and caused the tenant to pay substantially more than its fair share of operating costs for all years subsequent to the base year..

PSA Results

The owner agreed to increase the base year to include the imputed cost of the maintenance for the HVAC systems and elevators. This adjustment to the base year provided for an immediate reimbursement to the tenant of $7,000 and saved the tenant $27,500 in escalation payments over the lease term.

Total Savings: $27,500

P. Stevens Associates, Inc. (PSA)
Case Study #7
Base Year Audit Saves Tenant Substantial Amount Of Rent Over Lease Term

Project Outline

A tenant leased 20,000 square feet of a 600,000 square foot office building. The tenant's lease provided for an operating expense base year of 2004. When the tenant received a statement of the estimated 2005 expenses it was stunned to see that the operating expenses were projected to increase by 22% over previous years expenses. The tenant recognized that something did not appear correct and engaged PSA to help them determine if the projected rise in operating expenses was correct.

PSA Added Value

The audit revealed two key points. First, the average occupancy for the building in 2004 was approximately 65%. The average occupancy in 2005 is projected to be 75%. Second, although the lease language provided for the "gross up" of variable operating expenses, the owner had not made this computation for both the base year and the subsequent year. The substantial increase in operating expenses was due mainly to the fact that the 2005 variable operating expenses, such as cleaning, rubbish removal and management fees, were based on a building which was projected to have an average occupancy of 15% higher than the previous year.

PSA Results

PSA was able to successfully have the owner increase the base year expenses to what they would have been had the building been fully occupied. The 2005 expenses were also computed based on a fully occupied building. The estimated net effect of these changes is to reduce the tenant's operating expense obligation in 2005 by $9,000. Also, if the building is assumed to have an average occupancy of 85% in all years subsequent to the base year, the tenant will save a total of $102,000 over its entire lease-term.

Total Savings: $102,000.

P. Stevens Associates, Inc. (PSA)
Case Study #8
New Building Owner Changes Method of Billing Tenant for Escalations

Project Outline

A tenant leased 75,000 square feet of space in a 200,000 square foot office building, which had changed owners in 2005. The tenant received the 2005 true-up in early 2006 and was concerned that the change in ownership might affect how the tenant would be billed for operating escalations. The tenant engaged PSA to verify that operating escalations were being billed consistently.

PSA Added Value

The audit confirmed that the new owner was doing several things differently, regarding operating escalations, as compared to how the previous owner had done them. First, the lease provided for a management fee to be equal to 10% of the operating expenses or the actual cost paid to a property management company. The previous owner had self-managed the property and charged a management fee based on the former method, which equated to approximately $100,000 annually. The new owner had engaged a third-party manager with a traditional management contract based on a percentage of the gross building receipts. The fee paid to the third-party manager was approximately $160,000. Second, the former owner had included the cost of administrative personnel (manager, administrative assistant) in the management fee. The new owner permitted the third-party manager to charge the property $80,000 for the cost of the administrative personnel, in addition to the actual management fee paid to them. PSA argued that if the landlord was going to charge for management fee and administrative personnel with the new method, the base year amounts should be adjusted upward so that the expenses were determined on a consistent basis.

PSA Results

The owner agreed to increase the base year amounts for management fee and administrative personnel. These two adjustments increased the base year amount by $108,000 as saved the tenant $21,000 for 2005 and an additional $236,000 over the remaining lease term.

Total Savings: $257,000

P. Stevens Associates, Inc. (PSA)
Case Study #9
Landlord Fails To Properly Calculate Base Year Expenses

Project Outline

A tenant leased 140,000 square feet of space in a 145,000 square foot office building. The building was vacant for the first six months of 2004, while it was undergoing a complete renovation. The tenant took occupancy of its space in July 2004. The tenant's base year for operating expenses was 2004. When the tenant received the 2005 operating expenses it noticed a large increase in expenses over the base year amount. It was also concerned about the calculation of the base year expense amount in light of the large average vacancy during calendar year 2004. Recognizing the importance of verifying the accuracy of the base year amount the tenant engaged PSA to perform a base year audit.

PSA Added Value

The lease stated that operating expenses would be adjusted to what they would be if the building were fully occupied. When the owner developed the base year expenses it did not properly gross up the operating expenses for the first six months of 2004 when the building was totally vacant. This calculation error grossly understated the expenses and artificially depressed the base year amount. The audit also revealed that the owner had performed substantial amounts of deferred maintenance and had passed on this cost to the building's occupants. It was reasonable for the tenant to expect that the when the building was renovated that such maintenance would have been performed so that the tenant would be in effect taking occupancy in a new building from a building systems point of view.

PSA Results

The owner agreed to re-calculate the gross up of the 2004 base year expenses, which increased the total amount by $70,000. The owner also agreed to eliminate $50,000 of deferred maintenance expenses from 2005. As a result of the audit the tenant received a cash reimbursement of $151,000. In addition, the changes agreed to by the landlord will save the tenant an additional $310,000 over the remaining lease term.

Total Savings: $461,000

P. Stevens Associates, Inc. (PSA)
Case Study #10
Audit Saves Tenant Almost $1.1 Million

Project Outline

A tenant leased 190,000 square feet of space in a 300,000 square foot R & D building on a net basis. The tenant felt that the operating expenses were too high and met with the owner to discuss them. The tenant was not satisfied with the responses given by the landlord so they engaged PSA to perform an audit.

PSA Added Value

The audit uncovered four major areas where the landlord charged the tenant for questionable expenses. First, the tenant paid a cleaning vendor directly to clean its space. However, the landlord incorrectly grossed-up all cleaning related costs, thus causing the tenant to also be charged for cleaning as part of the building's expenses. Second, the owner had the building's financial statements audited as a requirement of a mortgage. The tenant received no benefit from the audited financials and therefore should not subsidize an owner's cost. Third, the owner charged the property for home office personnel involved in the preparation of the audited financial statements and the tax returns. These costs are incurred only for the benefit of the owner and not the tenant. Fourth, the building had an in-house café. The owner was charging the café's share of operating expenses and taxes to the remaining tenants in the building. This is not unusual when a building is somewhat isolated from other eating establishments as companies feel that it is better to subsidize a café than to have their employees leave the building to eat lunch. However, the owner was also receiving monthly income from the café owner, but was not offsetting this income against the operating expenses and taxes. PSA successfully argued that the excess charges noted above should not be the responsibility of the tenant.

PSA Results

The owner agreed to eliminate the expenses noted above and to offset the café income against the building operating expenses. The lease also had a look-back provision which stated that if an audit was done, and the owner agreed to reimburse the tenant for a specific overcharge, the tenant's auditor could go back an additional two years to determine if the owner had over billed the tenant for those specific items in the previous years. The lease also provided for interest due to the tenant if an audit revealed overcharges by the landlord. The tenant received a cash reimbursement of $450,000. In addition, the changes agreed to by the landlord will save the tenant an additional $630,000 over the remaining lease term.

Total Savings: $1,080,000

P. Stevens Associates, Inc. (PSA)
Case Study #11
Tenant in Mixed Use Complex Substantially Overbilled by Landlord

Project Outline

A tenant leased 200,000 square feet of space in a 1,200,000 square foot office building. The office building was part of a 3,000,000 square foot mixed use complex containing retail stores, hotels, a supermarket and parking garage near New York City. The tenant had seen a large increase in operating expenses and taxes and engaged PSA to audit the landlord's records.

PSA Added Value

The audit confirmed that the owner was improperly charging the office building for certain expenses. There were three key items which the audit revealed. First, the owner was over allocating real estate taxes to the office building. Real estate taxes which should have been charged to other components of the complex were being charged to the office building. Second, the property was managed by an affiliate of the owner. The lease stated that a management fee paid to an affiliate of the owner could not exceed the amount which would be paid to a third-party property manager based on an arm's length transaction. In spite of this the owner/manager was charging a management fee which was approximately twice the market rate paid to a third-party manger. Third, the lease provided that no executive personnel above the level of property manager would be charged to the office building. The owner had hired an on-site general manger to oversee the operations of the entire complex, plus additional property interests which the landlord owned in the metropolitan New York area. The compensation paid to this person was well beyond the amount which would be paid to a property manager to manage a 1.2 million square foot office building. PSA successfully argued that the excess charges passed on to the office building were in conflict with the lease covenants.

PSA Results

The owner agreed to recalculate the operating expense and real estate escalations charged to the tenant. The tenant was reimbursed $801,000.

Total Savings: $801,000

P. Stevens Associates, Inc. (PSA)
Case Study #12
Base Year Audit Reveals Incorrect Tenant Pro-rata Percentage

Project Outline

A tenant leased 80,000 square feet of space in a building which contained 400,000 square feet of office space and 100,000 square feet of retail space. The tenant had been to a presentation by PSA and was cognizant of the importance of auditing the base year operating expenses and real estate taxes. Therefore, PSA was engaged to perform the audit.

PSA Added Value

The audit substantiated the fact that the owner has properly established the base year amounts for operating expenses and taxes. However, in the course of the audit PSA recognized the fact that the owner was overstating the tenant's pro-rata percentage for its share of the building's expenses. When the owner established the amount of the operating expenses for the building it had included the expenses for both the office and the retail areas. However, the owner had calculated the tenant's pro-rata share based on the tenant's square feet over the square feet in the office building and not the square feet in the total building. This error had overstated the tenant's pro-rata share by approximately 160 basis points.

PSA Results

The owner agreed to recalculate the tenant's pro-rata percentage based on the amount of square feet occupied by the tenant divided by the square feet in the entire building, including the retail area. Based on a four percent projected growth in operating expenses and taxes the reduction in the tenant's pro-rata share will save the tenant $432,000 over its lease term.

Total Savings: $432,000

P. Stevens Associates, Inc. (PSA)
Case Study #13
Multiple Owners In Tenant's Base Year Creates Understatement Of Expenses

Project Outline

A tenant leased 120,000 square feet in a 350,000 square foot suburban office building. The tenant's lease provided for an operating expense base year of 2005. The building was owned by three different entities during 2005. The tenant was aware of the difficulties in accurately determining the operating expenses for a particular year when there are multiple owners and was also aware of the importance of auditing the base year expenses since this amount would be the threshold against which all future year's expenses would be compared to. PSA had been engaged by the tenant for audits at other locations, see case study #9, and the tenant engaged PSA to once again verify the accuracy of the base year expenses at this location.

PSA Added Value

The audit revealed two key errors. First, the owner which owned the building at the end of 2005 had consolidated the 2005 expenses from those that they had paid plus those paid by the two previous owners. However, they had failed to include all of the expenses for the two previous owners. Second, the average occupancy during the year was 54% and the lease provided that the expenses would be adjusted to what they would be if the building was 100% occupied. However, the owner had not properly grossed-up the utilities and contract cleaning to the amount that they should be for a fully occupied building. PSA was able to reconstruct the 2005 expenses from the three owners and then gross-up the utilities and contact cleaning expenses to what they would be had the building been 100% occupied.

PSA Results

PSA was able to successfully have the owner increase the base year operating expenses by $268,000 and was also able to increase the base year real estate tax amount by $79,000. As a result of the audit the tenant will save $724,000 over the remaining lease term.

Total Savings: $724,000

P. Stevens Associates, Inc. (PSA)
Case Study #14
Base Year Audit Reveals Major Errors By Landlord

Project Outline

A tenant leased 110,000 square feet of space in a building which contained 250,000 square feet of office space. The tenant had previously used PSA to perform a base year audit, see case study #12, on another property where the tenant leased space. The tenant recognized the value of base year audits based on the previous audit and engaged PSA to perform an audit on this leased premises.

PSA Added Value

The audit revealed that the owner had made two major errors when calculating the base year expenses. First, the lease provided that if the building was less than fully occupied during any lease year, expenses which vary with the building's occupancy would be adjusted to what they would be if the building were 100% occupied. The building was 88% occupied during the base year. However the owner only adjusted the variable expenses to what they would be if the building was 95% occupied. Therefore, expenses such as cleaning contract, cleaning supplies, water & sewer and trash removal were understated in the base year amount determined by the landlord. Second, when the owner grossed up the management fee expense it failed to account for the fact that although several tenants were occupying their spaces they were not paying any rent due to free rent provided in their leases. Therefore, although the physical occupancy was 88%, the economic occupancy of the building was less than 80%. PSA convinced the owner that the management fee should be based on a fully occupied building and with no free rent taken into account when determining the management fee.

PSA Results

The owner agreed to recalculate the operating expenses to what they would be based on a fully occupied building and also to re-calculate the management fee based on no deductions in gross rent due to free rent provided to specific tenants. Based on these changes the owner increased the building's base year operating expenses by almost $200,000 which saves the tenant $500,000 over its lease term.

Total Savings: $500,000

P. Stevens Associates, Inc. (PSA)
Case Study #15
Landlord Incorrectly Includes Capital Amortization In Operating Expenses

Project Outline

A tenant leased 140,000 square feet of space in a 145,000 square foot office building. The tenant had previously engaged PSA to perform a base year audit, see case study #9, but in the normal course of business asked PSA to perform a "desk top" audit of the 2006 expenses to determine if an audit would be advisable. Although the expenses did not appear out of line, PSA did ask the owner a few questions about specific expense account and based on those responses PSA recommended that a complete audit be performed.

PSA Added Value

The lease states that the only capitals which can be amortized and included in operating expenses are those that are there for the purpose of i) complying with a new law or ii) items installed to increase the operating efficiency of the Building. The owner had repaved the parking lot and had included the amortization of this capital expenditure into operating expenses. PSA pointed out the incorrect charge to the owner and the expense was eliminated from the operating expenses.

PSA Results

The owner agreed to re-calculate the operating expenses for 2006 and eliminate the amortization for all future years relative to this capital project. As a result of the audit the tenant received a cash reimbursement of $51,000. In addition, the changes agreed to by the landlord will save the tenant an additional $589,000 over the remaining lease term.

Total Savings: $640,000