

## **Boston/Cambridge Buildings Add Rentable Square Feet During The Last Decade**

If you think that some of the office buildings in Boston and Cambridge seem to be getting larger over the last decade you would be correct, well sort of. The amazing fact is that while the rentable area for many office buildings increased dramatically it did not occur as a result of any physical change. P. Stevens Associates, Inc. (“PSA”) performed an analysis, which tracks any office building in Boston or Cambridge that had at least 200,000 rentable square feet in 1997, and which was in both the 1997 and 2007 “Office Buildings Boston” magazine published by Yale Robbins, Inc. The information in this publication is supplied by the building owner or the owner’s agent as they pay to have their buildings advertised in this publication. There were other office buildings of 200,000 or more square feet that did not pay to advertise in either or both of the publications so they are not included in this analysis. Due to the sensitive nature of this information the actual study is not attached. However, PSA has both of the issues noted above and are they available for review.

With a sample size of fifty-one buildings, one building grew by 30%, three buildings grew from 20%-30%, eight grew from 10%-20% and nine grew from 5%-10%. The overall weighted average was exactly 5%. In fact, over 65% of the buildings increased in size with the largest exceeding 200,000 rentable square feet! Why does this phenomenon happen? How does it impact tenants financially? What can a tenant do to protect themselves? These questions are addressed below.

### **WHY DO BUILDINGS GROW?**

The reason that buildings increase in size over time can be attributed to several factors. First, if the prior owner of the building had understated the proper rentable area in the building it would be reasonable and appropriate for the new owner to correct this mistake. Second, there may have actually been physical construction to the building which added new rentable square footage. **PSA asked several senior level brokers in Boston/Cambridge to review the data and to the best of their knowledge not one of the buildings in the analysis had any such physical construction done.** Third, it is also possible that the owner simply added rentable square feet to the building in order to increase the building’s value. In this case the increase is not justified by any industry measurement standard such as the Building Owners and Managers Association (“BOMA”) measurement method. Many owners will manipulate the measurement in an effort to generate addition rentable square footage, which increases the building’s income and the resulting value. Remember, rentable square footage can mean something totally different to an owner than it does to a tenant especially if a standard, industry-accepted measurement method like BOMA is not used. If a tenant is willing to lease space in a building without doing the proper due diligence to determine the accuracy of rentable square footage, then the blame falls on them and their consultants. The owner is trying to create value and the tenant is allowing them to do so at its own expense.

### **WHAT’S THE RISK?**

The single largest financial risk to a tenant is to pay base rent based on an inflated rentable square footage that is unsupported by an accepted industry measurement method

such as BOMA. If the actual building add-on factor for a particular tenant's premises is 15% then why should the tenant pay base rent based on an add-on factor of 18%, 21% or something greater? If the proper add-on factor for the building is 15%, but the owner has re-measured the building to create an 18% add-on factor the tenant will be paying an additional 2.6% in base rent. If it is re-measured to create a 21% add-on factor the tenant will be paying an additional 5.2% in rent.

#### **WHAT'S THE SOLUTION?**

What should a tenant do to protect itself from paying for rentable square feet that doesn't exist? The easiest way to avoid this problem is to insist that the tenant's rentable square footage be determined by an accepted industry measurement method, such as BOMA, and **VERIFY** the calculation. Although this may require hiring an architect to verify the owner's computations this expense is extremely low if calculated over the length of the entire lease term. If an owner refuses the tenant's request to have the space measured by BOMA then the tenant can reasonably conclude that the measurements are inaccurate and that it will be paying for space that doesn't exist. Owners often provide for this "phantom space" by inserting language in the lease stating that the rentable square footage is simply an amount that is "agreed upon".

#### **OTHER FINANCIAL CONSEQUENCES?**

Another direct consequence to a tenant is that **an increase in rentable area of a building results in an immediate increase in real estate taxes**. When the municipal assessor determines the value of a building, one key component that they use is the rentable square footage provided by the owner. If the rentable area increases over a period of time the assessed property value will also increase as a direct result of this change. Therefore, a 10% increase in a building's rentable square footage results in the assessment being 10% greater and thus, the taxes being 10% greater. If the building's rentable area increases during the term of a tenant's lease, then the tenant pays for increased taxes that are due solely to the owner's desire to increase the size of that particular building in order to create value.

#### **WHAT DOES THIS MEAN FOR TENANTS?**

What does this mean in terms of real estate tax escalations to a tenant? PSA did an analysis of the City of Boston Assessing Department records for the Boston buildings that are generally considered Class A. For fiscal year 2008 the analysis included 46 properties. The actual real estate tax expense per square foot for these properties ranges from \$5.81 to \$11.45 with the weighted average being \$8.96. Therefore, if an owner increases the rentable square footage by 10% in one of these buildings it will cost tenants in that building between \$.58 and \$1.14 per rentable square foot in additional real estate tax escalations annually. The only clear winner in this scenario is the owner.

When we apply this concept of growing a building to operating expenses it is similar to that for real estate taxes, but with one key difference. We saw that increasing the building's square footage actually increased the taxes. Although an owner may increase the building's area, this should not increase any operating expenses, other than management fees which are typically paid as a percentage of gross building revenues.

However, it does affect the amount that the owner is reimbursed from the tenants as a whole. If the rentable square feet in a building has increased over time, and the owner has calculated each tenant's pro-rata share based on the square footage of the building at the time of the each lease commencement, then the total of the pro-rata shares in the building will actually exceed 100%! It's all smoke and mirrors, but as they say "it's good work if you can get it". The question really becomes why should the tenant continue to pay its original pro-rata share when based on the current building square footage the tenant's pro-rata share has actually decreased? The simple answer is it shouldn't. The equitable thing to do would be to adjust the tenant's pro-rata share based on the then current square feet in the building.

### **TENANT'S PROTECTION**

How can a tenant protect itself from paying for these real estate tax increases and also pay only its true pro-rata share of the operating expenses? Make sure the tenant has the proper language in its lease. Language such as the following would protect the tenant. "The Tenant's pro-rata shall be a quotient equal to the Tenant's rentable square footage over the Building's rentable square feet. If the rentable square feet in the Building increase or decrease during the Tenant's lease term the Tenant's pro-rata percentage shall be adjusted accordingly based on the new denominator".

PSA is a real estate consulting firm that only represents tenants and not owners. Its sole mission is to help tenants reduce rent costs by helping them write specific lease clauses and also by auditing the owner's annual operating expenses and real estate tax charges.

**In five years of performing lease audits PSA has saved tenants \$10.6 million.** If you would like to discuss this article please feel free to contact Paul Stevens at [paulstevens1@comcast.net](mailto:paulstevens1@comcast.net).