



Are You Over-Paying Your Landlord?

Operating Expenses: Control Costs & Avoid Risks

By: Keith O'Brien and Kyle O'Brien

When leasing commercial real estate it is essential to know what operating expenses* (OE) your company, as the Tenant, is responsible to pay. Also important, is knowing what rights within your lease can be negotiated in order to control and reduce OE post lease commencement. All too often OE, and how a Landlord expenses OE to the Tenant, is not fully understood. This could mean financial risk as a result of unreasonable or incorrect Landlord billing. Working with a knowledgeable real estate advisor and understanding a few basic facts are key to avoiding this risk.

Variations of Operating Expenses

Base Year: The twelve month period, typically the first calendar year of the new term, that is used to calculate the Tenant's

share of future OE. For example, if the base year OE (actual) were \$6.00 per square foot, the Tenant would be responsible for all building OE in excess of \$6.00 per square foot each year of the lease term following the base year.

Expense Stop: A fixed amount per square foot where the Tenant is responsible for all building OE in excess of said amount beginning in year one.

Triple Net (No Base Year or Expense Stop): All OE are passed through directly to the Tenant beginning in year one.

No one option above is necessarily better than another as other financial terms of the deal have weight. Tenants should know where the market rates are and how additional expenses related to the building's operation affect their annual occupancy costs. Only after those additional costs are esti-

FREE OPERATING EXPENSE ABSTRACT

Jackson Cross Partners will provide your company with an operating expense CAM** abstract. The abstract will provide your administrators with a tool to validate your Landlord's annual CAM reconciliation against the operating expense terms in your Lease **free of charge**.

If you are interested, please contact us via e-mail or by telephone using the contact information located in the column to the left.

**Common Area Maintenance

mated will a Tenant know if their deal is fair market.

Operating Expense "Caps"

There are additional rights that can be negotiated in any of the three scenarios above. Controllable OE are those expenses that can be managed by the Landlord. These expenses are typically all expenses except taxes, insurance, utilities and snow removal, although certain circumstances may provide room for negotiation. Non-controllable OE are all additional expenses that are out of the Landlord's control. Negotiating a 'cap' on controllable OE can save a company

hundreds, or even thousands of dollars per year. In addition, there are numerous other fees for which a cap can be negotiated, including but not limited to, annual CPI increases, administrative fees, property management fees and others.

Lease Financial Audits

Most monthly OE invoices are an estimate of the current year's actual OE. Accounts collected by the Landlord are reconciled at the end of the year with the actual expense. At this time, the Tenant receives a credit or an invoice depending upon whether the estimated OE were larger or smaller than the actual.

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*When using the term OE throughout this article, CAM, taxes and insurance are assumed to be included in this term.

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Should the Tenant be presented with an invoice, many times the payment is made without any review for financial accuracy or compliance with the Lease terms.

Lease financial audits often result in the identification of misapplied or

miscalculated common area maintenance (CAM) reconciliation, annual rent adjustments, or other financial obligations of the Landlord or Tenant. The errors may be further compounded by time, since the undiscovered errors are typically carried forward year after year of the lease. Cate Sennett, an

attorney and Director of Advisory Services at Jackson Cross notes: "It is incredible to see the number of times in reviewing a lease file, how often the rent or other financial obligations of both Tenant and Landlord are either miscalculated or misapplied. We have been involved in numerous situations

where the variances have ranged from a few hundred dollars to over one hundred thousand dollars."

When negotiating Lease terms during an office relocation, a Lease renewal, or a Lease restructure, it is imperative to reduce financial vulnerability. Resetting the base year

or expense stop, negotiating OE caps, and performing lease financial audits annually, can allow companies to take control of a line item that is all too often overlooked. ■

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See front for details.

Thank you for reading our 3rd edition of the Jackson Cross Partners Green Paper. The goal of the publication is to promote business efficiencies by providing information that aids in your reduction of occupancy costs through "green" initiatives as well as innovative cost reduction platforms.

Sincerely,



Keith A. O'Brien



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