

Case Study #10

New Building Owner Changes Method Of Billing Tenant For Escalations

Project Outline

A tenant leased 38,000 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 either 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 10% 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 current owner was going to charge for management fee and administrative personnel using the new methods then 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