

## **Case Study #3**

### **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 mid 2004 and 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 believed that the calculation of the base-year expense amount might be understated due to the large 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 was 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 in 2005 and had passed on this cost to the building's occupants. It was reasonable for the tenant to expect that 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 \$105,000. 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**