10 Cost Savings Opportunities In Real Estate Lease Administration

Developed For:

lease accelerator™

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With the deadline for implementing the new lease accounting standards on the horizon, trillions of dollars of operating leases will soon move onto the balance sheets of corporations worldwide. At most companies, real estate represents the largest asset category in the leasing portfolio. As organizations upgrade systems, processes and controls to support the new accounting standards, many are also taking a closer look at real estate functions to identify potential cost savings opportunities.

Many companies have already tackled the “quick wins” in real estate business processes - those that generate million-dollar savings opportunities. However, significant cost saving opportunities still remain, including improvements to the accounts payable, collections, and contract management processes. For example, many companies fail to properly manage subleases. Invoice discrepancies are still common. And critical contract dates to exercise expansion or renewal options, often at discounted rates, are frequently missed. The cost savings realized from each of these individual improvements to your real estate portfolio might be relatively small. However, collectively the savings can add up to significant cost reductions along the lines of 2-4% of total real estate portfolio spend.

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In this guide, we will outline ten potential cost savings opportunities for real estate lease administration, which include:

01 DESKTOP AUDITS	Are you conducting periodic desktop audits of your real estate leases to identify errors? If not, you may be over-paying for common area maintenance charges, property insurance or local taxes.
02 FULL-SCOPE AUDITS	Are you monitoring for unauthorized expenses when new landlords take ownership of a property or when significant occupancy changes occur? If not, you may be helping fund building improvements for new tenants and helping the landlord recover missed income from unoccupied space.
03 SUBLEASE COLLECTIONS	If you're subleasing some of your portfolio, are you properly collecting revenues from your subtenants? Many companies do not pass along the costs of increases in variable rent or operating expenses to their subtenants.
04 TENANT IMPROVEMENTS	Are you tracking allowances for tenant improvements throughout the lease? If not, you could be foregoing cash reimbursements or upgrades to your leased space.
05 SECURITY DEPOSITS	Are you collecting security deposit refunds owed to you at the end of a lease? If not, you could be forfeiting hundreds of thousands, if not millions, of dollars to landlords.
06 COMMENCEMENT DATES	Are your accounts payable teams using the correct commencement date to start rent payments? If not, you may be over-paying monthly rent at your properties.
07 CRITICAL DATES	Are you proactively monitoring the critical dates in your real estate leases? If not, you could be passing up opportunities to renew or expand leases at discounted rates.
08 PAST END OF TERM	Are you paying for leases on properties that you no longer occupy or forgetting to renew leases on time? If so, you could be losing tens, if not hundreds, of thousands of dollars.
09 LATE RENT	Are you consistently processing and paying your real estate leases on time? If not, you may be incurring costly late fees.
10 SPACE OPTIMIZATION	Does your headquarters team have visibility into the true space utilization of various properties around the world? If not, you may be paying for thousands of empty cubicles and conference rooms.

There are two main avenues companies can take to realize these savings:

01 CENTRALIZED CORPORATE REAL ESTATE ORGANIZATIONS:

Making changes to the organizational structures and business processes that support real estate.

02 LEASE ADMINISTRATION SOFTWARE TECHNOLOGY:

Investing or further leveraging lease administration software or integrated workplace management systems (IWMS).

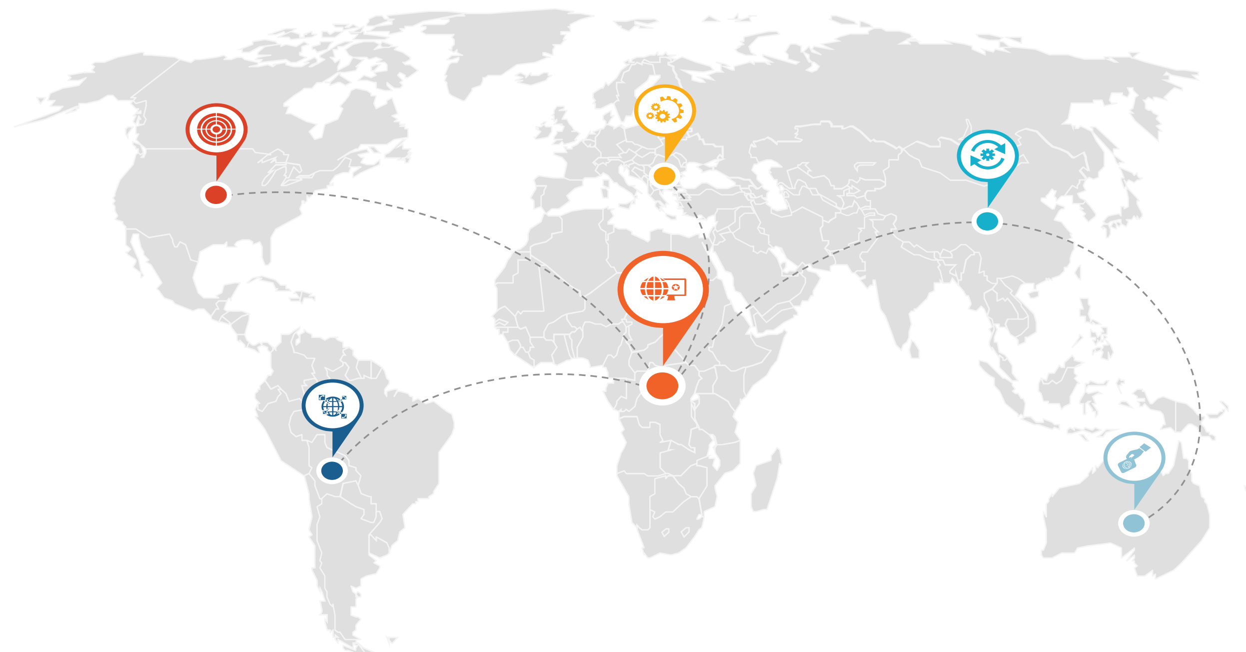
Companies can achieve significant cost reductions along the lines of 2-4% of total real estate portfolio spend through the use of lease administration software and centralization of real estate functions.

CENTRALIZED CORPORATE REAL ESTATE ORGANIZATIONS

1

Historically, real estate portfolios at large companies have been managed in a decentralized structure. The regional teams in each geography or country acted autonomously, making decisions to support the needs of local operations. While a decentralized approach provides empowerment to local organizations, it does not enable the optimization of the real estate portfolio across the enterprise.

CENTRALIZED VERSUS DECENTRALIZED REAL ESTATE ORGANIZATIONS



Over the past twenty years, companies have increasingly centralized all real estate functions across geographies and business units into a single, global organization. These centralized, corporate real estate organizations own everything from new construction projects and capital budget planning to building maintenance and lease administration. Some or all of the functions are outsourced to specialized real estate providers.

CENTRALIZED CORPORATE REAL ESTATE ORGANIZATIONS

1

Within these centralized real estate organizations, best-in-class companies have established and built a small team of experts in lease negotiation and administration. These "Leasing Centers of Excellence" are staffed with professionals averaging ten or more years of experience in the complexities of

- Sourcing and structuring deals
- Administering and maintaining facilities
- Analyzing and auditing invoices
- Negotiating expansions and renewals
- Overseeing property managers and vendors

By centralizing lease administration functions, companies are able to adopt standardized best practices across the enterprise for each of these business processes.

A 2015 JLL study found that 31% of companies had implemented a Global Corporate Real Estate organization, while 61% of organizations expected a greater level of centralization and control in real estate programs over the coming years.

LEASE ADMINISTRATION SOFTWARE TECHNOLOGY

2

In addition to building centralized organizations and standardizing business processes across the enterprise, most companies have implemented technology as well. Some organizations have invested in a lease administration software application to track all of their data, including contacts, clauses, and locations. The software can automate the workflows associated with exercising lease clauses such as rights to expand, contract, renew, terminate, and purchase. Additionally, the technology can be used to manage the invoice-to-pay process for landlord bills and the invoice-to-cash process for subtenants.

INTEGRATED WORKPLACE MANAGEMENT SYSTEM

Capital Project Management	Lease Administration	Property Management	Sustainability Management	Space & Facilities Management	Maintenance Management
Planning, funding, management of new facilities or remodeling.	Contacts, clauses and critical date management. Lease and document repository.	New site identification, and development.	Energy efficiency, waste recycling, renewable groundwater. Carbon credit calculation.	Moves, adds, changes. Environment, health and safety. Physical security.	Preventative maintenance. Work orders. Parts and inventory management.

LEASE ADMINISTRATION SOFTWARE TECHNOLOGY

2

Some companies have taken a more holistic approach to applying technology to their real estate portfolio by deploying integrated workplace management systems (IWMS). Typically, an IWMS application will include all the features of a real estate administration application. In addition, an IWMS includes powerful features such as capital project management functionality to enable the design, funding, bidding, construction, cost, and resource management of new facilities. These applications also perform building administration, maintenance, and repair functions. Some IWMS even monitor energy consumption, energy efficiency, pollution absorption, and the calculation of carbon credits.

Both lease administration software and IWMS technologies complement and accelerate the benefits of a centralized, corporate real estate organization across geographies. By optimizing the people, processes, and technology associated with real estate lease administration, organizations can unlock the potential savings opportunities available to them.

Centralizing leasing data in a real estate administration application is a key foundational step to identifying cost savings opportunities in sublease collections, security deposit recovery and critical date management.

10 Real Estate LEASE COST SAVING OPPORTUNITIES

DESKTOP AUDIT

01

The inherent complexity and price variability of real estate contracts results in the associated invoices being highly prone to errors. Industry experts estimate that 60% of all landlord bills are incorrect. Unfortunately, the burden often falls upon the tenant to validate charges found on the monthly rent statements to ensure accuracy.

The payment structures for commercial real estate leases can be quite complex. Rents can vary year-to-year based on market rates, sales performance, or predefined escalations. The simplest type of gross lease has a fixed monthly rent payment over the term of the lease. But many gross leases also have payment schedules that can vary over the term of agreement.

EXAMPLES OF VARIABLE RENT STRUCTURES INCLUDE:

ESCALATION CLAUSES

Some leases have a scheduled rent escalation clause that results in an increased payment at pre-determined points in time. For example, there might be a planned escalation every year of $0.10 per square foot.

MARKET INDICES

Alternatively, a rent payment might be linked to a market index such as the Consumer Price Index (CPI) or the Wholesale Price Index (WPI), which could vary up and down as economic conditions change.

PERFORMANCE-BASED

Another common rent model is to link payment amounts to the sales or another financial variable of the tenant. For example, many retail store lease payments are tied to annual sales volume.

DESKTOP AUDIT

01

Taxes, insurance, and operating expenses can vary month-to-month depending upon how costs are divided between landlord and tenant. Perhaps, the most problematic aspect of net lease invoices is the common area maintenance (CAM) charges, in which the landlord passes through operating expenses shared across tenants. CAM charges might be for services such as utilities, trash removal, landscaping, snow plowing, physical security, and parking lot management.

The allocation of pass-through expenses is often performed by the landlord's lower-level accounting personnel. In many cases the personnel generating the bills may simply follow the same boilerplate methodology for applying expenses to each tenant, rather than reviewing and applying the uniquely-negotiated terms of each individual lease. And even if each individual lease is reviewed, the accounting personnel determining the allocation may not properly interpret the specialized clauses and legal terminology included in the leases. After all, the property accountant was not party to the negotiations, but is still required to interpret what may be vaguely-worded legalese. This can be a significant source of billing errors.

Even if the tenant's real estate team is sufficiently resourced, a junior lease administrator reviewing an invoice may not be able to spot inconsistencies between a lease agreement and a monthly invoice. In these scenarios, the trained eye of a 20-year real estate leasing veteran may be required. Best practice is to have a real estate leasing expert conduct a "desktop audit" of all expenses at least once per year, and a more extensive, full-scope lease audit in certain circumstances.

The desktop audit includes an examination of all landlord invoices to confirm the validity of billing methodologies, the accuracy of calculations, and the eligibility of pass-through charges. As the term suggests, the audit is conducted at the reviewer's desk.

DESKTOP AUDIT

01

OPERATING EXPENSES

Janitorial Services	Advertising Expenses
Landscaping Services	Inspection Fees
Physical Security	Accounting Fees
Snow Removal	Travel Expenses
Artwork	Legal Fees
Parking Lot Expenses	Office Rental
Light Bulbs	Property Management

- TENANT ALLOWANCES
- GROSS UPS
- ESCALATION CAPS
- PROPERTY TAXES

Operating expenses are often a primary focus area for desktop audits aimed at determining whether the appropriate CAM charges are being included or excluded.

For example

A tenant may have agreed to pay for:

01 Janitorial expenses
02 Landscaping fees
03 Electrical utilities
04 Snow plowing
05 Physical security
06 Property management fees

However, the lease terms may have specifically excluded costs, such as:

01 Advertising expenses
02 Inspection fees
03 Membership dues
04 Legal fees
05 Accounting expenses

DESKTOP AUDIT

01

A desktop audit will attempt to confirm that the line items being billed on the invoice accurately reflect the terms in the contract.

LANDLORD EXPENSES - Some landlords may try to pass on expenses such as rent for their corporate offices, salaries for their employees, deductibles for insurance claims, or travel costs to visit the properties. Are these allowable under the terms of the lease?

CAPITAL IMPROVEMENTS - such as remodeling the lobby, installing a new HVAC system, or repaving the parking lot are often controversial. Can these costs be passed through by the landlord to the tenant? And are they billed as one-time charges or via a series of monthly fees amortized across the life of the asset?

ESCALATION CAPS - Are expenses whose amounts depend upon changes from the base year being calculated correctly? Are there caps on operating expenses, real estate tax increases, or insurance policy changes that have been exceeded?

GROSS-UPS - For multi-tenant buildings, were the gross-up calculations used to divide costs between tenants calculated correctly? How are the costs being allocated when parts of the building are unoccupied as tenants move in or out?

ALLOWANCES - Have incentives such as move-in allowances and free-rent periods been reflected in the invoices? Did the landlord invoice for expenses that should have been funded through tenant improvement allowances? Were unused funds eligible to be applied as credits towards the rent?

REAL ESTATE TAXES - Is the landlord charging for taxes assessed on adjacent development parcels? Did the landlord perform a successful tax appeal, resulting in tax credits or refunds that should be returned to the tenants? A simple call to the tax assessor's office can uncover thousands of dollars of potential savings and recoveries.

For each lease there can be hundreds of potential billing issues. As a result, a desktop audit of real estate leases should be performed at least once per year. The first year audit is often the most important as it serves as the base year upon which future operating expenses, taxes, and insurance costs are determined. Errors in the base year could compound for the entirety of the lease term.

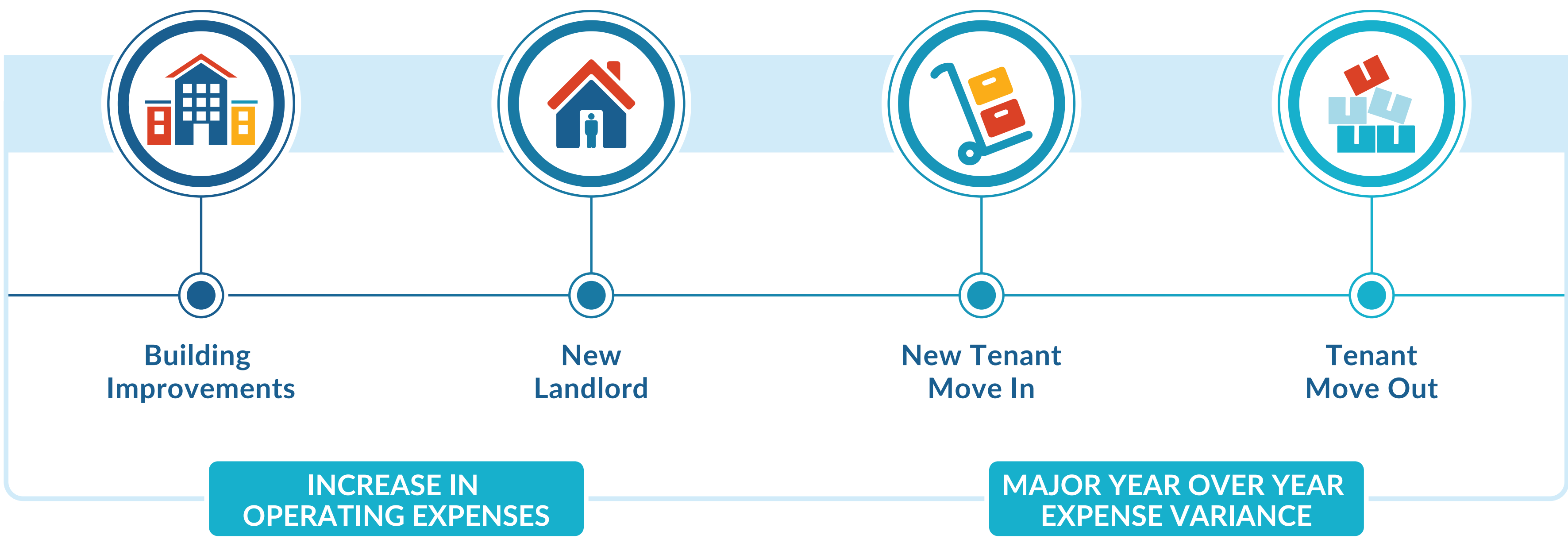
Industry experts estimate that 60% of all landlord bills are incorrect. Unfortunately, the burden often falls upon the tenant to validate charges found on the monthly rent statements to ensure accuracy.

FULL-SCOPE LEASE AUDITS

A full-scope lease audit is typically justified when a desktop audit contains material errors that require more in-depth examination. It is usually conducted in the landlord's office as it requires a detailed review of accounting records, invoices, contracts, and other related lease documentation.

Major "change events" are another trigger for full-scope audits. Examples might include when the building changes ownership, when there are major building improvements or when the occupancy changes considerably. A new landlord may bill differently or interpret contract terms differently. When new tenants move in there are usually investments and capital improvements that the landlord may inadvertently (or intentionally) try to pass on to all tenants. When tenants move out, landlords may try to recover some of the tax, insurance, or operating expenses associated with the unoccupied space from the remaining tenants. Other triggers for audits might be a noteworthy increase in operating expenses or a significant year-over-year variation in certain expense categories.

FULL SCOPE AUDIT TRIGGERS



FULL-SCOPE LEASE AUDITS

02

A real estate lease administration application can automate many of the time-intensive tasks associated with desktop and full-scope lease audits. For example, these software applications may perform automated error calculations to identify over-billing scenarios. The software might automate the workflows associated with dispute management such as generating landlord correspondence, issuing credit letters, and tracking response status over a multi-week or multi-month period. Additionally, some real estate lease administration applications can report on year-over-year expenses by category, as well as log the savings generated from reducing billing discrepancies.

While the sophistication of auditing technology available in real estate administration software applications continues to improve, more complex real estate portfolios still benefit from the trained eye of a real estate leasing expert to pinpoint errors. Best practice is to have experts from a Leasing Center of Excellence conduct periodic desktop and full-scope lease audits using a combination of expert analysis and automated reports from a lease administration application.

Numerous case studies have shown that periodic reviews of rent charges against contract terms can yield savings of one-half to a one full basis point.

Apply Best Practices from Accounts Payable to Real Estate Invoices

Apply Best Practices from Accounts Payable to Real Estate Invoices

Not all billing errors require the trained eye of a real estate leasing expert. Some discrepancies can be easily identified by accounts payable clerks. These invoicing problems are not unique to real estate expenses, but common across a variety of spend categories. For example, landlords sometimes send duplicate invoices for the same property and billing cycle. Others might continue to send bills for properties that have been vacated and whose leases have been terminated. And, as is possible with any invoicing cycle, the landlord may fail to apply credits for payments that were already submitted, or correct billing errors that were identified in a prior cycle. Applying best practices for invoice validation in your accounts payable organization can help to detect these errors.

COMMON INVOICING ERRORS

- **Duplicative Landlord Invoices**
- **Missing Credits or Payments**
- **Post-Lease Termination Billings**
- **Excessive Passthrough Charges**

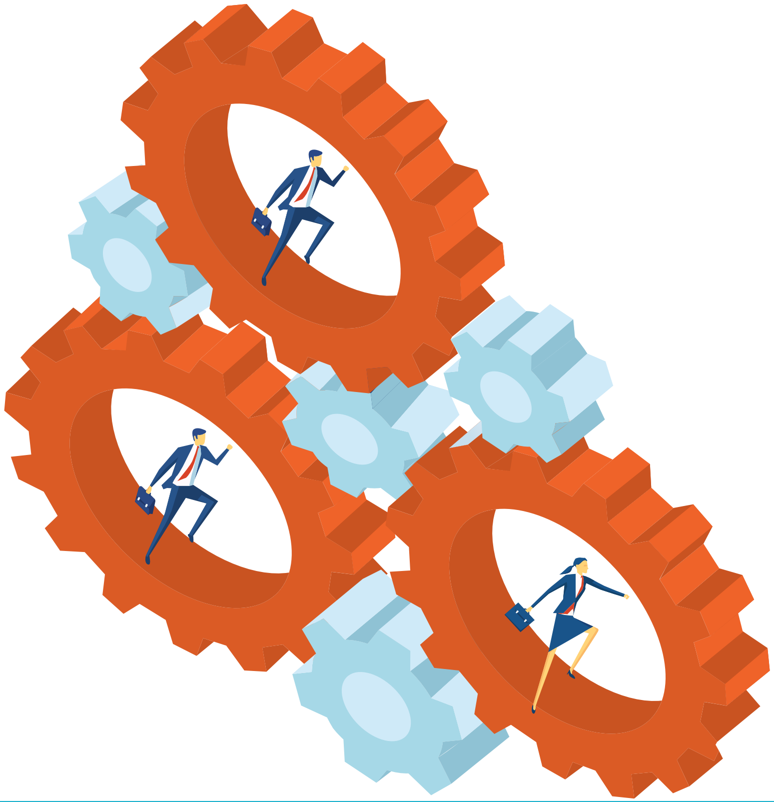
Numerous case studies have shown that periodic reviews of rent charges against contract terms can yield savings of one-half to a one full basis point.

SUBLEASE MANAGEMENT

During the term of a lease, a tenant may find that they have more space than is needed for their operations. There could be several root causes for the excess space. Perhaps, the company's growth plans and sales ambitions were never realized. Perhaps, some back office functions were outsourced to a third party organization. Or perhaps, the preference towards the geographic location of certain functions has changed due to recent mergers or acquisitions. Regardless of the root cause, companies often seek to sub-lease or assign unused space in their buildings to other tenants.

In some scenarios, the subtenant(s) may have a direct relationship with the landlord and make payments directly. In other sublease scenarios, the primary tenant is responsible for managing all the subtenants and making the full rent payment directly to the landlord. And many companies do a poor job of managing these sublease arrangements, particularly the collection of receivables from the subtenants.

Most tenants are busy conducting their primary business, which might be running a retail store, a professional services organization, or a warehouse operation. The typical corporate real estate group is set up to deal with landlords, but not resourced, trained, or prepared to act as one. While tracking subtenants and the associated receivables might sound simple, many corporate real estate groups find it to be quite a challenge. Large companies may have not just one, but many different sublease arrangements at different properties around the world. And it is often not clear who within the organization is responsible for ensuring that invoices are generated to, and rent is collected from, subtenants.



A separate monthly billing process must be set up to create sublease invoices. However, generating an accurate invoice can be a challenge, especially for net leases. The calculations for base rent, operating expenses, insurance, and taxes might vary by subtenant as the terms of each individual sublease vary. As a result, there may be a need to generate many different invoices in many currencies with many tax schemes on a recurring basis.

SUBLEASE MANAGEMENT

COLLECTION FAILURES

Some organizations simply forget to collect the rent owed to them by subtenants. The process for issuing sublease invoices may not be automated, but dependent upon a few individuals manually generating a bill each month. If those key personnel change roles or become busy with projects they may simply forget to issue invoices.

BILLING INACCURACIES

The calculations for base rent, operating expenses, insurance, and taxes might vary by subtenant as the terms of each individual sublease vary. Each month a real estate manager will need to review landlord expenses then determine the appropriate costs to pass on to subtenants. At most companies the process is manual and prone to error.

ACCOUNTING ERRORS

Most collections staff are well versed in booking receivables for the primary goods and services offered by their company. But when a check is received from a subtenant, it can lead to confusion and inappropriate recordation in the AR ledger. Ideally, a documented procedure exists for processing subleases, but for companies with only a handful of subtenants these exception scenarios might fall through the cracks.

LANDLORD ROYALTIES

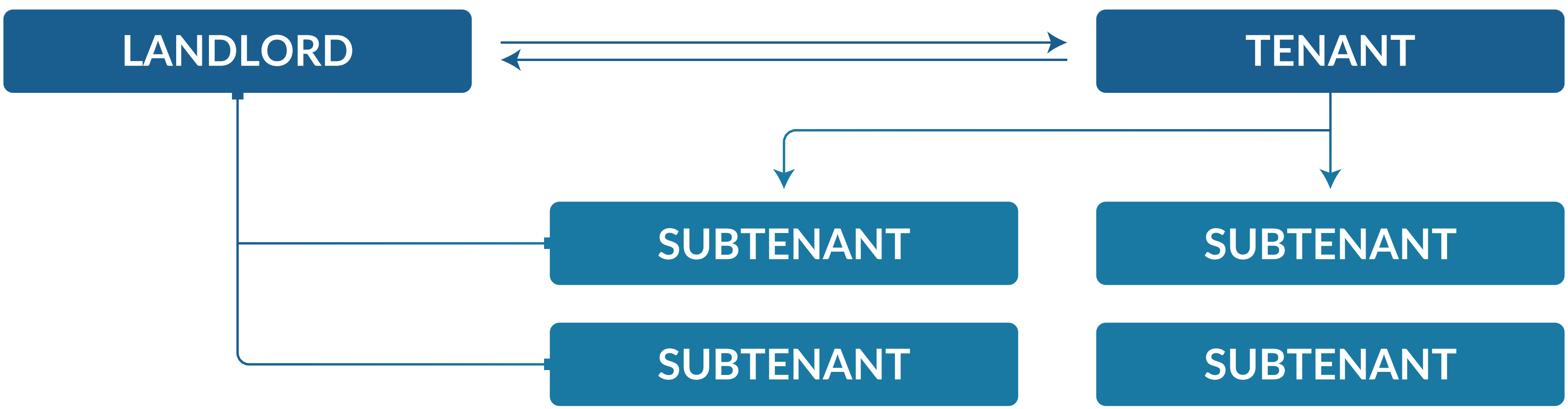
Some landlords require that a portion of the subtenant rent be shared with them. For example, if the subtenants are being charged a higher rent than the primary tenant, the landlord may require a profit sharing arrangement. Someone in the real estate department will need to review the receivables from subtenants each month, calculate the amount owed to the landlord and then request accounts payable transfer the funds.

SUBLEASE MANAGEMENT

03

Lease administration software applications may include capabilities to automate the monthly invoice-to-cash process for these subleases. Automation will ensure the consistency of billing and improve the accuracy of calculations. Lease administration applications also help with monitoring the quality and timelines of receivables. For example, some applications can generate reports on aged delinquencies. Real Estate professionals can drill down on the payment history of individual tenants by viewing the specific invoices and cash receipts. More advanced lease administration applications can interface with accounts receivable applications to post cash receipts against balances on tenant accounts.

SUBLEASES



Another best practice to consider is outsourcing the day-to-day responsibility for sublease management. Using a business process outsourcing approach, a third party can calculate pass-through charges, generate monthly invoices, and monitor delinquent accounts.

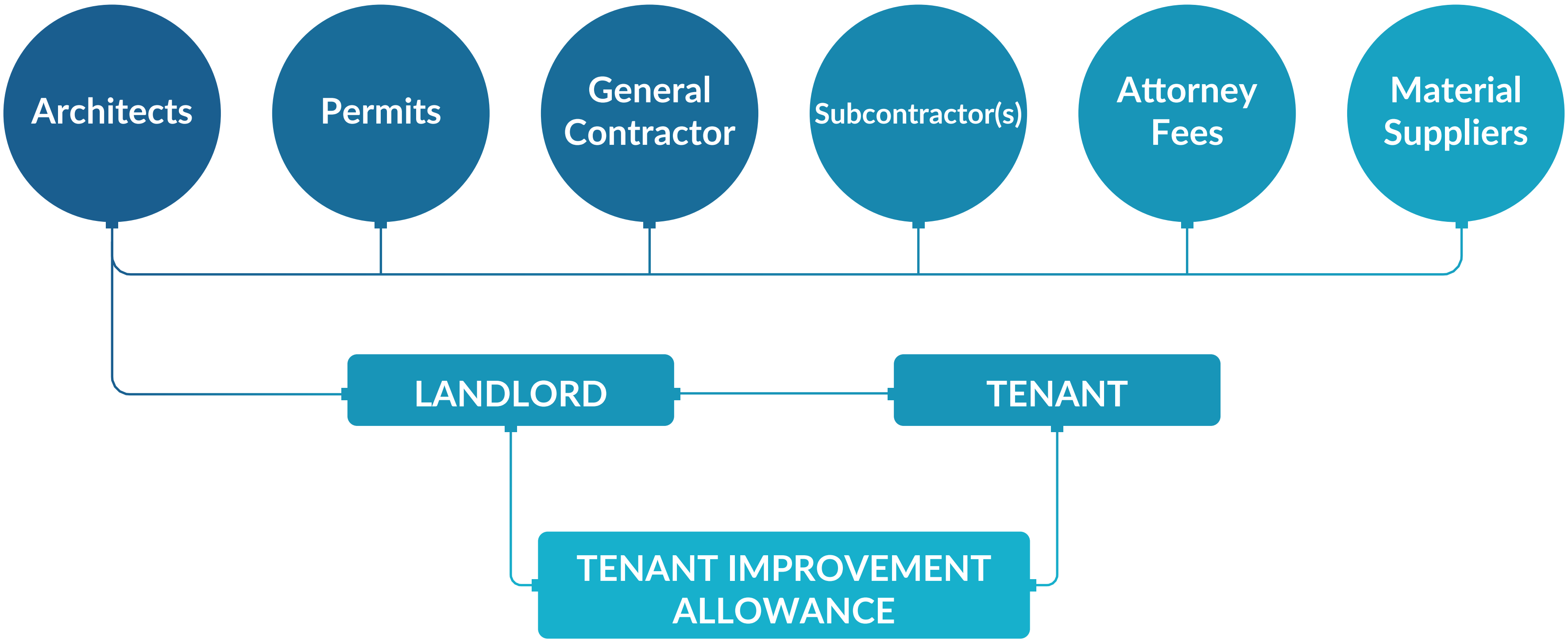
Most tenants are busy conducting their primary business, which might be running a retail store, a professional services organization, or a warehouse operation. The typical corporate real estate group is set up to deal with landlords, but not resourced, trained, or prepared to act as one.

TENANT IMPROVEMENT ALLOWANCES

Many commercial real estate leases include incentives and allowances that help tenants to subsidize costs associated with using the property. For example, some landlords offer a moving allowance to defray relocation costs. Perhaps, the most common incentive is the tenant improvement allowance that can be used to customize or upgrade the space being leased.

Tenant improvement allowances can be used to fund minor enhancements, such as fresh paint or new carpets, as well as major expenditures, such as adding an office kitchen or reconfiguring space. Depending on how the lease is written, the allowances may also be used to pay expenses associated with the improvements, including attorney fees, permit charges, and moving costs.

TENANT IMPROVEMENT ALLOWANCES



TENANT IMPROVEMENT ALLOWANCES

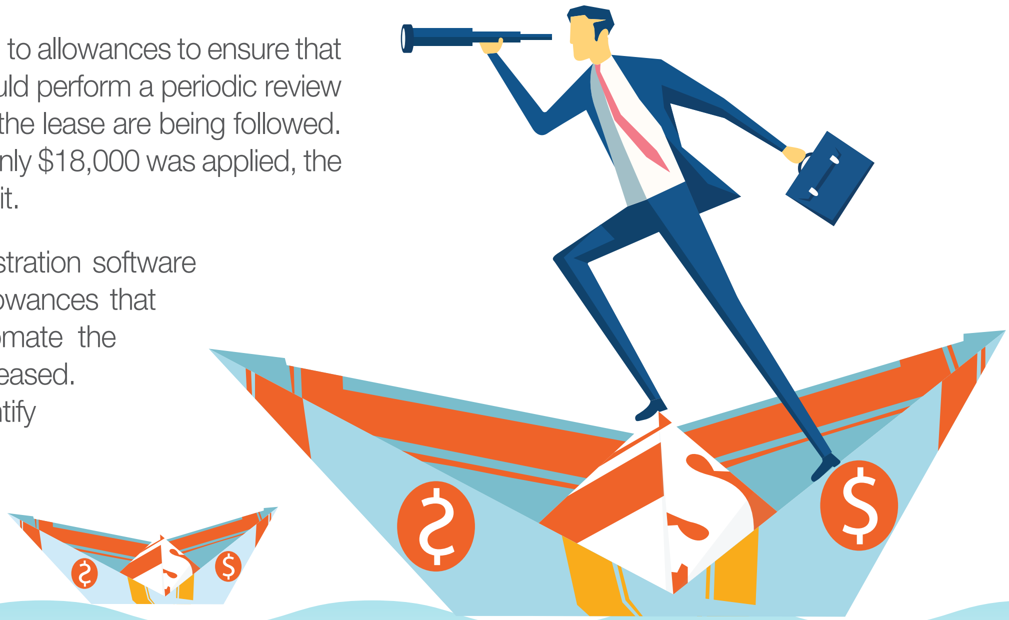
04

Tenant improvement allowances might be allocated as a total dollar sum or as an amount per square foot of space. To avoid potential tax consequences, many tenants prefer not to actually receive the allowances in cash. Instead, the landlord uses the allowances to pay contractors and suppliers. However, such an arrangement makes it challenging for tenants to track usage of the funds.

Corporate real estate teams often forget about tenant allowances that are available at various points throughout the term of the lease. Typically, the lease will define very specific timeframes and methods for applying tenant improvement allowances from the landlord. If not tracked properly, the tenant could effectively forfeit several hundred dollars per square foot at any given location. While the losses from any one property might be inconsequential, the aggregate missed savings opportunity could be substantial.

Tenants should institute a process to be notified of critical dates related to allowances to ensure that no opportunities for enhancements are missed. Additionally, they should perform a periodic review the balance of tenant allowances to ensure that the specific terms of the lease are being followed. If an improvement allowance of $20,000 was written in the lease, but only $18,000 was applied, the lease may stipulate that the remaining $2000 be issued as a rent credit.

A Leasing Center of Excellence in combination with a lease administration software solution, can be effective in maximizing the collection of various allowances that might be available pursuant to the lease. The software can automate the tracking of allowances and critical dates for each property being leased. Reports can be run quarterly by the Center of Excellence to identify allowances at risk of being forfeited. Additionally, the allowances can be reviewed in an annual desktop or full scope audit to ensure that the landlord followed the processes outlined in the lease.



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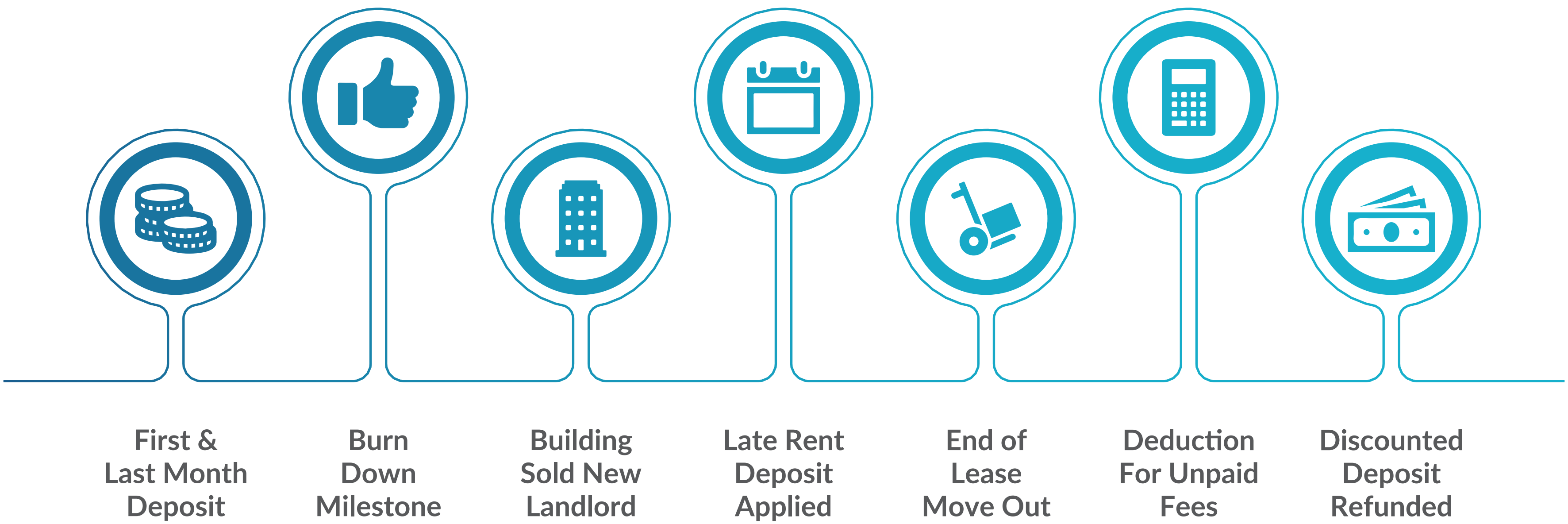
SECURITY DEPOSIT RECOVERY

05

Most real estate contracts require the tenant to pay a security deposit at the onset of the lease. Typically, with commercial leases, the first and last month's rent are required. The purpose of the deposit is to protect the landlord in the event that the tenant fails to pay rent or another financial obligation. Landlords also use security deposits to cover the cost of repairing damage to the premises caused by the tenant.

SECURITY DEPOSITS



The security deposit is supposed to be returned at the end of the lease following move-out and fulfillment of any remaining contractual obligations. However, most leases do not specify a timeframe or process for the landlord to refund the security deposit. With commercial real estate leases lasting five, ten, or even twenty years, the chances are good that the individuals involved with setting up the original lease are in a different role or at a different company, by the time the lease expires. As a result, the new players responsible for terminating the lease may unknowingly neglect to request a refund of the security deposit. Uncollected security deposits, if discovered, can be obtained up to three to seven years after the lease expires. Statutes of limitation vary by state.

SECURITY DEPOSIT RECOVERY 05

Determining the amount to be refunded can be complicated. The level of funding for a deposit might change during the term of the lease. Most tenants prefer not to have funds tied up in a security deposit for the full term of the lease. Tenants with stronger credit and business histories may negotiate a burn down that requires the landlord to gradually refund some or all of the deposit if bills are consistently paid on time. In other cases, the tenant may negotiate financial milestones that trigger a gradual reduction and return of the deposit.

Of course, the balance of a security deposit also may drop if the landlord applies the money towards overdue rent or other uncollected obligations during the term of the lease. In these scenarios, the tenant will need to replenish the funds. The balance might also drop at the end of a lease. The landlord may deduct from the security deposit to reclaim expenses associated with damages to the property or the removal of trade fixtures, wiring, or other modifications required to return the property to its original condition. Each of these factors complicates the calculation of the balance of a security deposit.

Lease administration software can track the leases with security deposits. Automated workflows can be configured to alert real estate professionals to request a refund of the deposit after the lease is terminated. Some applications offer reporting on the list of outstanding security deposits to be collected, along with automated notifications and escalations for monies that are at risk of being forfeited.

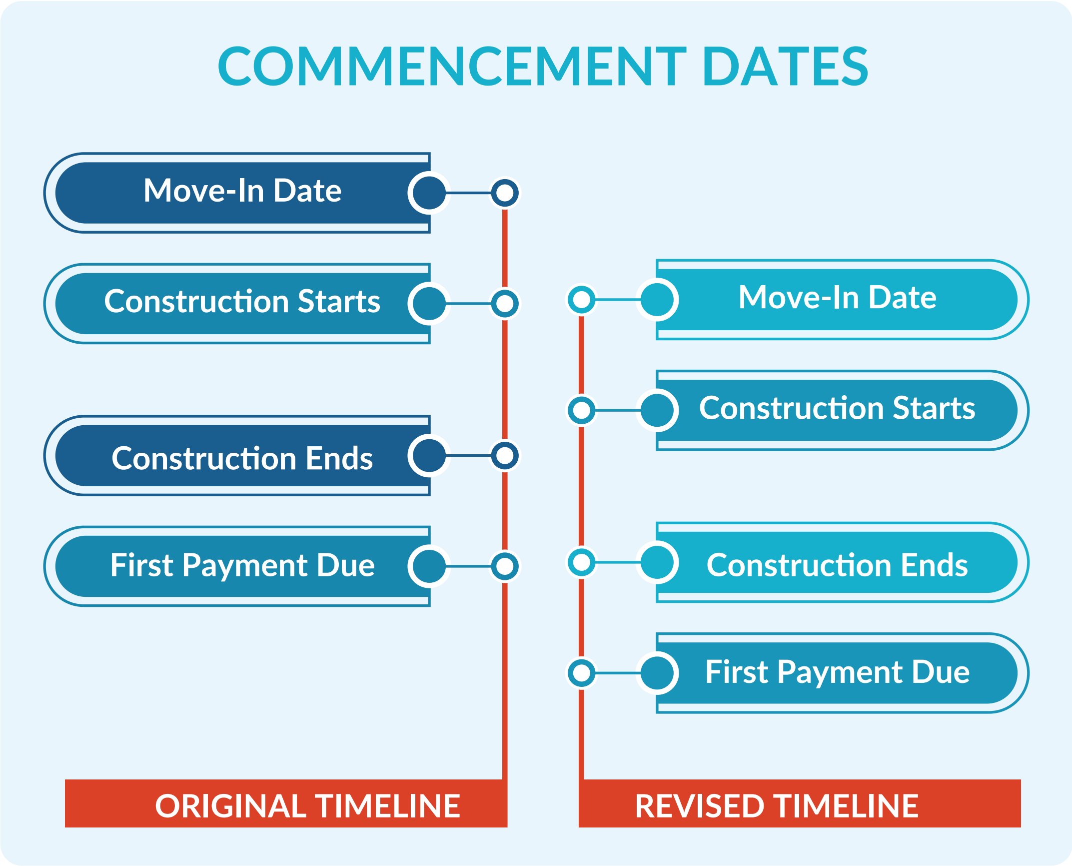
Another best practice is to charge the Leasing Center of Excellence with ensuring that all security deposits are tracked and refunded. The real estate team can conduct a periodic review of all upcoming planned lease expirations and recently terminated agreements to identify deposits that need to be refunded. The Center of Excellence can then take ownership of contacting landlords, requesting refunds, tracking collection activities, and pursuing legal action, if necessary to secure the funds.

With commercial real estate leases lasting five, ten, or even twenty years, the chances are good that the individuals involved with setting up the original lease are in a different role or at a different company, by the time the lease expires.

COMMENCEMENT DATE ERRORS

06

One of the common opportunities for cost reduction with real estate leases relates to the rent commencement date. These commencement dates are used to define when the tenant takes on responsibility for paying the landlord for use of the space. In most cases, the commencement date is correlated with when the tenant will begin to actually use the space. However, this date is not always easy to determine. The commencement date that the landlord and tenant agree to during lease negotiation often changes after the contract is signed. The availability of the space is often delayed due to tenant improvements or planned alterations.



Construction time tables for improvements and alterations are notoriously difficult to predict. The landlord and tenant might plan for these upgrades to take 90 days, only to find that the design, construction, and inspection phases end up taking 120 days. There are a variety of reasons for potential delays. The prior tenant may not move out on schedule, which could have a cascading impact on any planned construction work and move-in activities. The landlord and tenant may not agree to the design plans or there may be need for additional negotiations about the costs of the improvements. Often, the construction work may take longer than expected. For example, the landlord's primary contractor may be re-prioritized, especially if an occupant such as the anchor tenant has a concurrent project requiring the same workers. Once the improvements are completed there may be delays getting local building officials to complete an inspection and issue a certificate of occupancy.

COMMENCEMENT DATE ERRORS

06

Despite the potential for complications, there are a number of ways the rent commencement date can be determined. In some leases, the tenant and landlord agree to a date based on the projected timeframe for completion of the improvements. In other cases, the commencement date may float based on when the work is actually completed. Typically, a written notice is provided by the landlord or tenant depending on who is managing the improvements once work is completed. The notice is followed by an inspection to ensure the quality of the work and conformance to expectations. Once the work is complete, a week or two might be allotted for the tenant to move in and install trade fixtures.

The floating nature of rent commencement dates can lead to scenarios in which rent payments start before they should. When a new lease is established, it is common for the accounts payable department to review the lease and set up a recurring payment to the landlord. For example, Accounts Payable may set up a recurring payment of $20,000 per month starting on April 1st for the new office. However, if the A/P team is not informed that the rent commencement date should be moved to April 20th, then they may have scheduled recurring payments to begin prematurely. As a result, the tenant will end up over-paying rent obligations. Early payments can also accelerate rent escalations which further exacerbates the problem. Applying an incorrect commencement date for a single property may not be a significant expense, but repeating these mistakes across a portfolio of properties can add up to significant cost leakage for tenants.

The use of a Leasing Center of Excellence can reduce issues associated with commencement dates. The team would be charged with supervising the tenant improvements and move-in process for all new leases. As a result, the Center of Excellence would be in a position to know when rent payments should be initiated. The team would be responsible for notifying A/P of any changes to planned commencement dates.

The commencement date that the landlord and tenant agree to during lease negotiation often changes after the contract is signed. The floating nature of rent commencement dates can lead to scenarios in which rent payments start before they should.

MANAGING CRITICAL DATES

Many commercial real estate contracts include options that tenants can exercise during certain windows of the lease term. For example, a tenant might have an expansion rights clause that can be exercised during year three of a five-year lease or the tenant might have the option to purchase the property outright at the end of a lease. Most landlords also include an option to renew the lease and secure the space with sufficient advanced notice. However, many tenants miss the opportunity to exercise these options because they are not monitoring the critical dates associated with each lease.

MANAGING CRITICAL DATES

MANAGING CRITICAL DATES

OPTION TO RENEW

Missing the window to renew a lease can have several impacts. Some options to renew include pre-negotiated lease rates that might be less than the market rate for similar properties, so missing the window to renew at these more favorable terms could lead to an eleventh-hour lease renewal re-negotiation. In these scenarios, the tenant may have lost negotiating leverage and may end up with a higher than desired rent payment. In the worst case scenario, the landlord might lease the space to another company. As a result, the tenant may have to go through an expensive relocation process, including searching for a new property, negotiating tenant improvements, and hiring a moving company to transport the assets. The new location may not be as favorable for employees, customers, or business partners. Ideally, lease renewal negotiations would begin 12-18 months in advance of end of term, allowing the tenant to compare all relocation alternatives to their current lease renewal options. Starting early also allows the tenant to potentially leverage competition in the marketplace to negotiate more favorable terms.

OPTION TO EXPAND

A similar set of potential impacts exist for tenants that fail to exercise an option to expand. First, a tenant may have paid an upfront fee on the lease in exchange for a future right. As a result, tenants may end up paying fees for options they neglected to exercise. Second, the option to expand may be exercisable with pre-negotiated rent schedules that could be below market relative to other similar properties available for lease. For example, the tenant may be able to expand into contiguous space with the same monthly rent and same operating expense contribution as the original lease. Third, if a business is growing quickly, the tenant might forgo the opportunity to lock-in much needed expansion space. The landlord could secure another tenant, forcing expansion to occur in another, less convenient nearby location.

TERMINATION OPTIONS

Termination clauses and options to reduce space can be equally impactful if missed. There may be several reasons why a business suddenly needs less space or prefers to vacate a property. Perhaps the tenant has been acquired by another company who prefers to locate its workers in another region. Maybe the tenant has outsourced certain functions to a third party and downsized its direct workforce. Or the tenant may not have realized its sales ambitions and therefore has less need for the space. Missing an option to reduce space could result in the tenant continuing to pay rent for lots of unoccupied space or taking on the administrative challenges of sub-leasing. In some leases, failing to notify a landlord of a desire to terminate could result in having to make several unplanned rent payments.

MANAGING CRITICAL DATES

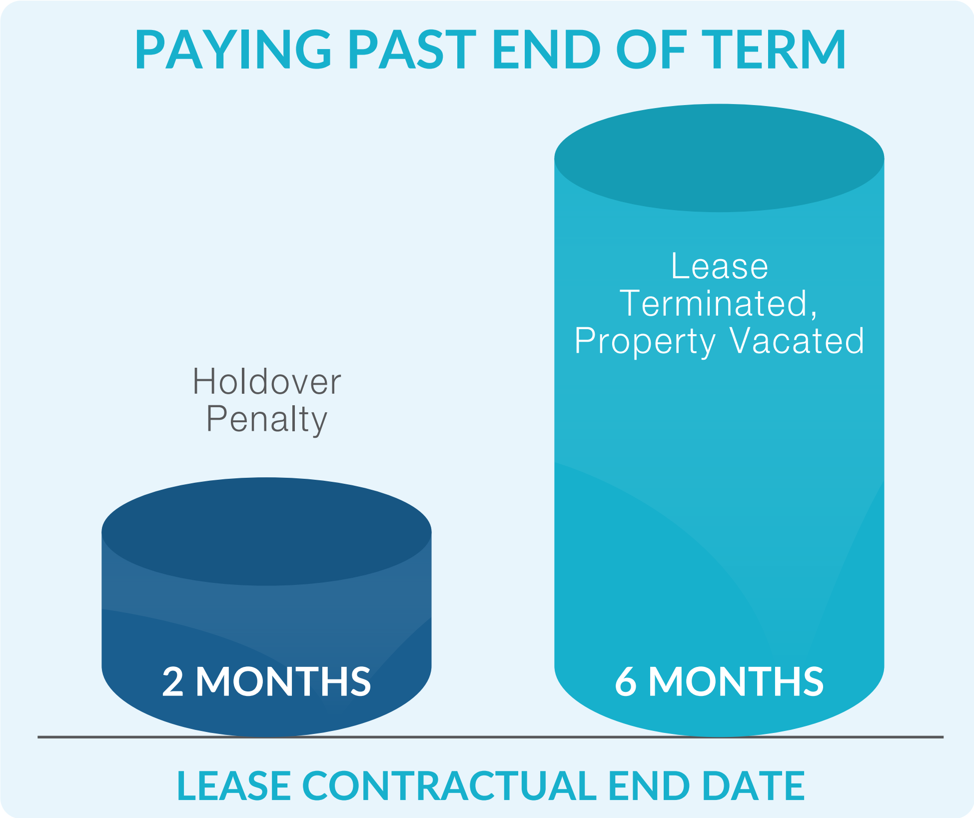
Lease administration software applications can track all the critical dates associated with your real estate properties. Automated notifications alert decision-makers in the Center of Excellence when an option to expand, option to renew, or termination notice date is approaching. Once stakeholders select an option, automated workflows ensure that everyone from the landlord to the legal team are notified of the changes. Reminders and escalation workflows can be configured to alert real estate leaders when a critical date is at risk of being missed with no action having been taken.

Many tenants miss the opportunity to exercise these options because they are not monitoring the critical dates associated with each lease. In these scenarios, the tenant may have lost negotiating leverage and may end up with a higher than desired rent payment.

PAYING PAST THE END OF THE LEASE

08

Most real estate landlords will charge holdover penalties for tenants that occupy a property beyond the end of the lease. There could be several reasons why a tenant might find themselves in a holdover scenario. A tenant might have planned to relocate at the end of a lease, but the new property is not available due to construction delays or because the existing occupant has not moved out. In other cases, an understaffed and overworked real estate team may simply forget to notify the landlord of an intention to renew the lease. While the tenant can typically remain in the space during these situations, the landlord will charge a premium of 150-200% of the normal rent. The holdover penalties might only last a few months until the situation gets sorted out, but repeatedly paying these premiums across a large percentage of the portfolio could be quite costly.



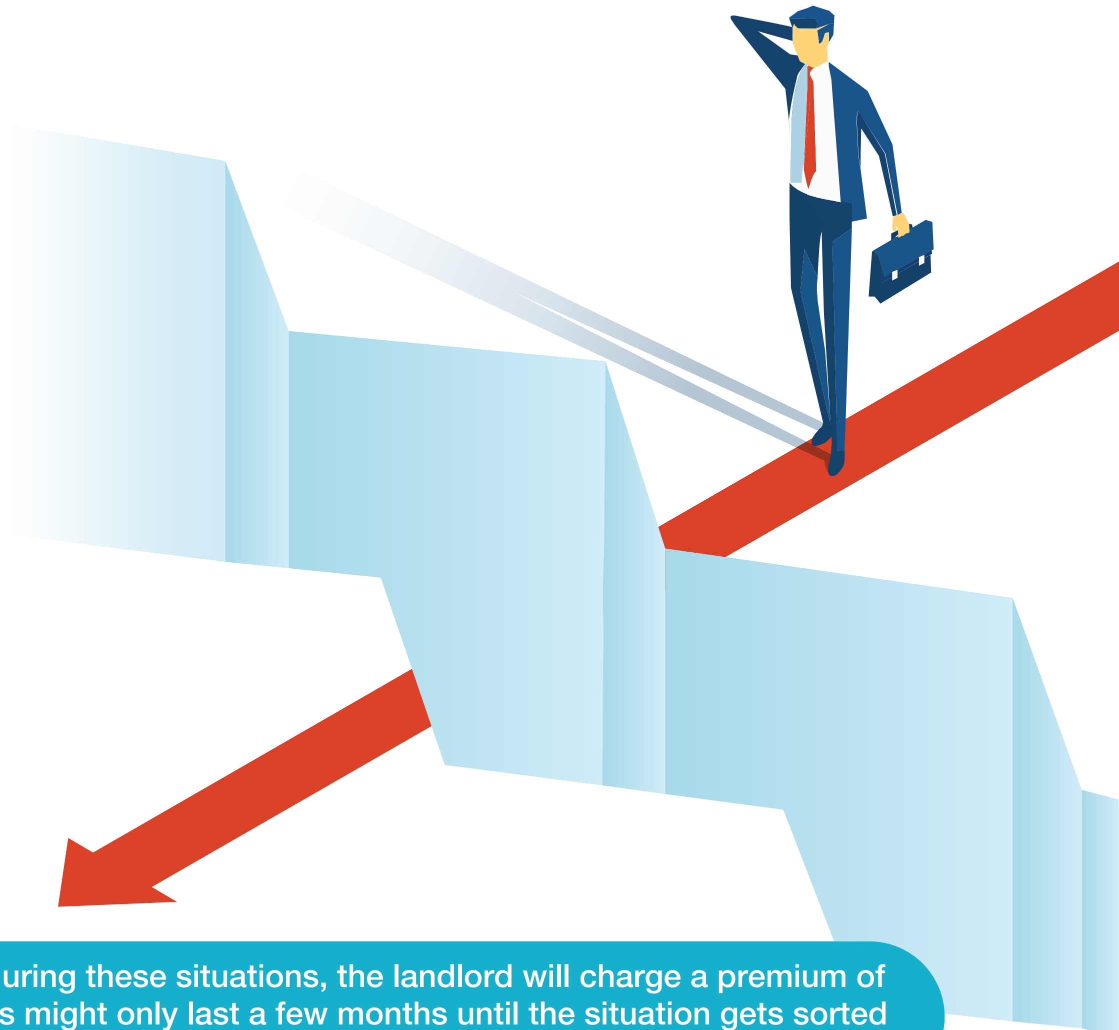
More problematic and expensive than holdover penalties are scenarios in which tenants are paying for properties they no longer occupy. Sometimes a division will vacate a building, but not inform Accounts Payable that the lease has been terminated. For example, suppose the New York City team decided to relocate its office, but failed to tell the A/P Shared Service Center of the change. A/P continues to pay the rent on the old office, sometimes for several years if the landlord continues to send invoices or if an automated recurring payment was established.

PAYING PAST THE END OF THE LEASE

08

Lease administration software applications can help to reduce the risk of holdover payments. Alerts can be configured to notify executives if a lease is near its expiration date and no option to renew, terminate, or buy the property has been executed. Additionally, lease administration applications can identify holdover penalties by comparing expected rent charges to the actual billings. These invoice discrepancies can be flagged to ensure that holdover situations are resolved as soon as possible.

A Leasing Center of Excellence can reduce the likelihood of paying past the end of the lease term. A centralized real estate function will be aware of any move-outs that occur in properties around the world. These organizations can institute a more standardized process for the end of lease that ensures A/P organizations are properly notified so payments are discontinued. Centers of Excellence can also focus on critical dates associated with renewals, ensuring that no deadlines for lease extensions are overlooked.



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LATE RENT

09

Most landlords will charge late fees if rent is not received within the agreed upon timeframe stated in the lease contract. For example, a landlord might apply a 10% late fee for payments not received within 30 days. Late payments are more common than you may expect for real estate invoices. While one late fee may not represent a significant dollar amount, consistently paying late fees on various properties could result in a six or seven-figure cost leakage. Companies with highly manual, long-running invoice processing workflows are typically the most exposed to potential late fees. There could be multiple root causes for the delay.

One root cause of payment delay is from the time it takes to capture the invoice and the necessary data. Many smaller landlords do not have the capability to send invoices electronically via EDI (Electronic Data Interchange) or a supplier portal. Instead, the invoices are sent via postal mail or attached as a PDF in an email. The key data fields from the paper or PDF invoice then need to be abstracted and then entered into the accounts payable application.

Some landlords forget to provide the requisite information needed to process the invoice such as the general ledger code or remit-to address. As a result, an accounting clerk needs to research the missing data with internal stakeholders or call the landlord's billing department.

Another cause for delayed invoice processing is the extensive time required to validate the line-items on the bill. Net leases have operating expenses, property insurance, and tax expenses that can vary month-to-month. A best practice for real estate leases is to have the A/P or real estate team validate that each of these expenses is allowable under the terms of the lease prior to approval. The validation process might extend the invoice approval cycle by several days since the terms and conditions of the lease schedules will need to be reviewed and then matched to the line items on the invoice.

LATE RENT

09

A third root cause for delays could be the time required to secure the necessary approvals. A company may require many different tiers of approvals for high-dollar real estate invoices. The approvals are often required from some of the busiest people in the company including the CFO and CEO. Delays can also be introduced by processes that occur outside of an automated accounts payable workflow such as paper documents or email-based approvals. As a result, moving invoices through the workflow in time to make a payment may not be realistic in some organizations.

Lease administration applications do not offer any magical features to overcome the hurdles of invoice processing. However, other technologies such as electronic invoicing and accounts payable automation software can be effective in reducing approval cycles and increasing on-time payments. Of course, the benefit of these e-invoicing and A/P automation technologies is not limited to real estate, but rather all payments made across the enterprise.

A Leasing Center of Excellence can also be effective in reducing the frequency of late payments. The benefits to real estate invoice processing are simply from the additional visibility and focus that these organizations can provide.

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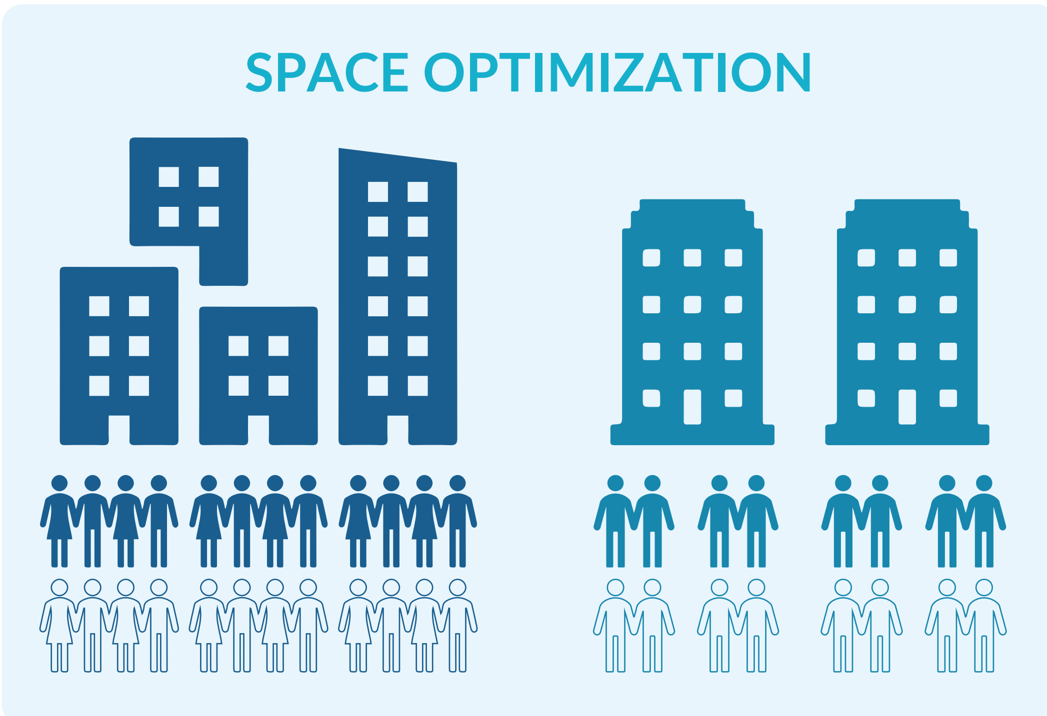
SPACE OPTIMIZATION

A recent Accenture study found that, on average, companies have 30-50% more real estate space than they need. A variety of forces are driving the under-utilization from corporate divestitures and offshoring to cultural shifts and technology adoption. Shared space, such as meeting rooms, are occupied only 30% of the time. With the proliferation of smart phones, video conferencing and tele-commuting, fewer employees are working in office. In fact, almost 70 percent of office employees regularly work at alternative locations.

Under-utilization is typically driven by a lack of visibility into the supply of available real estate and the true demand for the space by employees. While these factors may be understood for the headquarters locations, real estate teams rarely have visibility into overseas properties in far-flung geographies.



Best-in-class organizations proactively manage their real estate portfolio to ensure that space utilization is optimized. Typically, the corporate real estate team or an outside consultant will develop a long-term portfolio strategy that analyzes the supply of current space and the demand for future space to arrive at an enterprise-wide roadmap for real estate.

To forecast real estate demand, a company will need to understand its top line growth strategy along with variables such as planned outsourcing initiatives; expected workforce reductions; anticipated geographic expansions; and desired merger, acquisition, or divestiture goals. Factors such as the demographics of the workforce, use of technology, and cultural preferences of management will need to be considered as well.

SPACE OPTIMIZATION

10

To analyze the current supply of real estate, companies must create an inventory of property locations and sizes – both leased and owned. Then, they need to determine the number of seats and the active employee population assigned to each location.

Armed with this data, corporate real estate groups can begin to analyze space utilization metrics such as the number of square feet per employee. They can then explore a variety of options for reducing unnecessary real estate expenses. In certain geographic regions, real estate teams may be able to consolidate multiple office locations. Other locations with low space utilization can be re-configured and sub-leased to another tenant. Shared office and hoteling options create even further efficiencies.

Implementing a lease administration application is a critical prerequisite for successful ongoing portfolio optimization. Performing a supply analysis depends on having a complete and accurate, up-to-date system of record for all properties. For each lease, the corporate real estate group should understand not only the location and rent, but also applicable end dates; tenant improvements; and options to terminate, expand, contract, or purchase the space. Real estate planners can then optimize decisions about which leases to renew, which to terminate, and which to expand, or contract.

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SUMMARY OF BEST PRACTICES FOR REDUCING THE COSTS OF REAL ESTATE LEASES

01

DESKTOP AUDITS

Conduct regular desktop audits of your real estate invoices. Ensure that operating expenses and variable rents are being calculated correctly. Confirm that contractual clauses such as free rent periods are reflected in landlord invoices. Consider outsourcing to a specialized real estate lease administration provider or developing a Center of Excellence to conduct the audits.

02

FULL-SCOPE AUDITS

Conduct full-scope audits in scenarios such as ownership changes, building improvements, or occupancy changes. Ensure that capital improvements made for new tenants are not being passed on to you. Confirm that landlords are not attempting to recover tax, insurance, or operating expenses associated from unoccupied space.

03

SUBLEASE MANAGEMENT

Ensure that rent is being collected from subtenants. Validate that collections include not only base rents, but also accurate variable rents and pass-throughs of common area maintenance charges. Consider establishing structured processes, systems, and owners for the collection and management of sublease receivables.

04

TENANT IMPROVEMENT ALLOWANCES

Ensure that moving and tenant improvement allowances written into the lease are not being forfeited due to inaction. Implement a system to track critical dates and monitor allowances throughout the lease term

SUMMARY OF BEST PRACTICES FOR REDUCING THE COSTS OF REAL ESTATE LEASES

05

SECURITY DEPOSIT RECOVERY

Institute a process to systematically recover security deposits for leases that are not renewed. Ensure that information about the upfront deposits are well documented in lease administration systems. Develop a process that ensures knowledge is not lost as personnel change jobs and contracts are renewed.

06

COMMENCEMENT DATES

Ensure that monthly rent payments are issued based on the actual commencement date, which can often change during the early part of a lease. Establish a strong communication line between Accounts Payable and the real estate team to ensure that notifications are sent if tenant improvements, construction work, or move-in delays push back the commencement date.

07

MANAGING CRITICAL DATES

Capitalize on the expansion and renewal option clauses offered in leases. Leveraging these contractual options may offer opportunities for cost savings, such as locking in rents at below market rates. Use the workflow features of a lease administration software application to ensure that all critical dates are communicated to decision makers so action is taken before deadlines.

08

PAYING PAST END OF TERM

Ensure that key stakeholders are aware of all upcoming lease end dates. Be sure to notify landlords of desire to renew space. And be sure that relocation strategies are in place to avoid paying unnecessary holdover penalties. Confirm that Accounts Payable is notified when a property is vacated to avoid paying rent on facilities no longer in use.

SUMMARY OF BEST PRACTICES FOR REDUCING THE COSTS OF REAL ESTATE LEASES

09

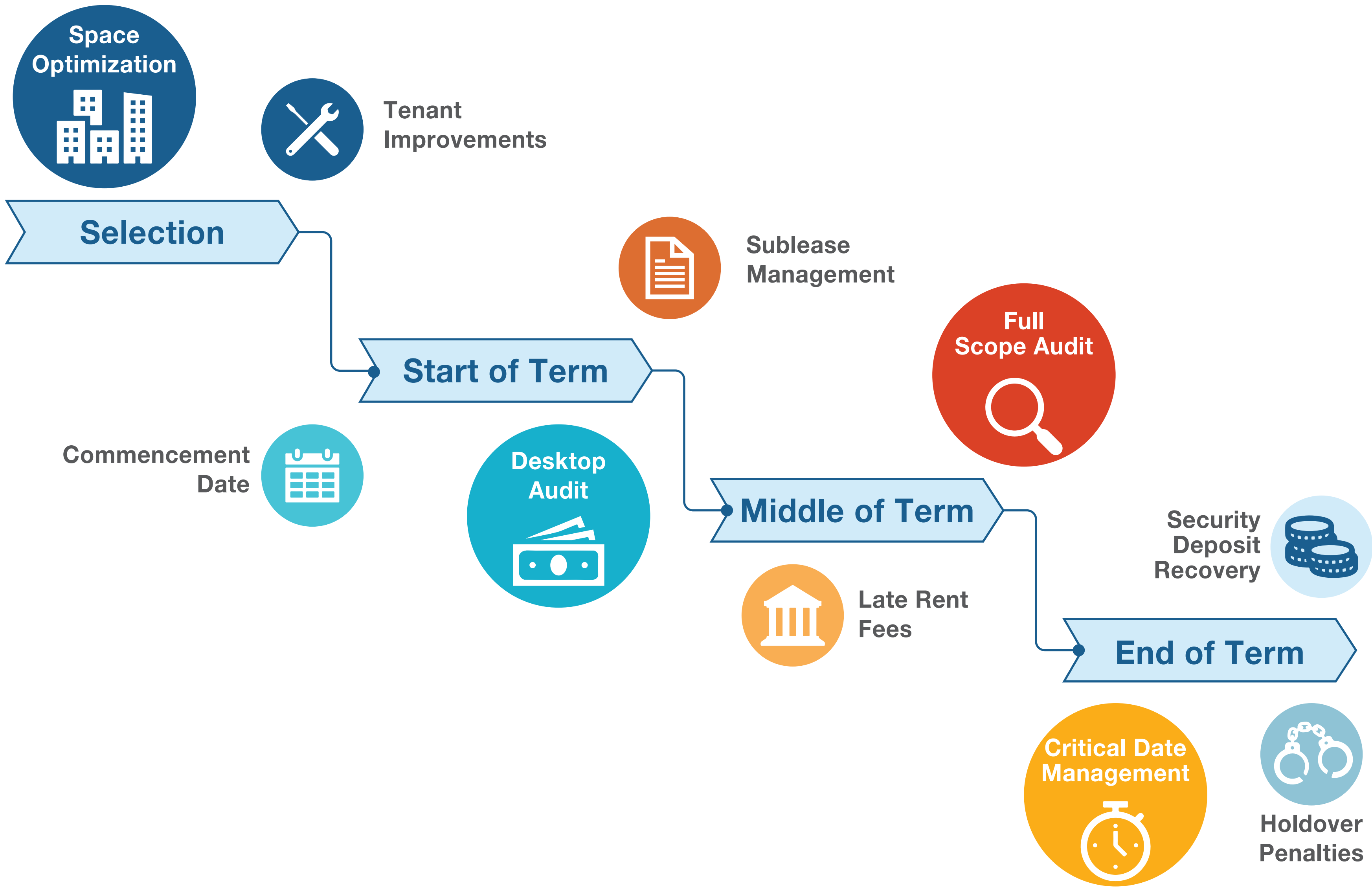
LATE RENT

Ensure that the accounts payable team is aware of contractual terms for rental payments and that approval workflows allow for timely processing of the payments. Report on the percentage of real estate invoices paid late and the associated late fees incurred to provide visibility into the leakage.

10

SPACE OPTIMIZATION

Periodically assess the utilization of workspace to understand the economics of leases. Team up with Human Resources to compare actual to expected headcount per facility to identify which spaces are underutilized and pinpoint opportunities for short-term and long-term cost savings.


Space Optimization
Tenant Improvements
Selection
Sublease Management
Start of Term
Full Scope Audit
Commencement Date
Desktop Audit
Middle of Term
Security Deposit Recovery
Late Rent Fees
End of Term
Critical Date Management
Holdover Penalties

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