The lease was negotiated and signed a year ago, the billings from the landlord are coming in and you realize that what was budgeted for rent and additional rent is much lower than the cost the landlord is billing. It begs the question, why?

Most likely the answer is that the additional rent components of the lease such as common area maintenance (CAM), real estate taxes, and insurance (C/T/I) or if you are in an office building the operating expenses, are much higher than anticipated. This has been dubbed by many as the “Hidden Rent.” Over the years, the trend of landlords over-billing additional rent has become more aggressive. One reason is the result of the shareholders pushing for more profits by the real estate investment trusts (REITS). Another reason is the lack of legal consequences or penalties in the lease to the landlord for over-billing a tenant. Thus, landlords continue to bill aggressively, and it has become the tenant’s responsibility to review these billings to avoid paying the overcharges.

The lease language dictates what a tenant is responsible for paying, and the leverage the tenant has when negotiating the lease dictates the lease language.

However, no matter what shape the deal takes, every tenant should incorporate a thorough review of its landlord billing process. In the commercial real estate industry this is called the desktop review and can achieve significant savings for a tenant. The desktop review is designed to catch the overcharges before the tenant pays it. This is important, especially for a tenant with smaller square footage, because it is much harder to collect the overcharges from the landlord once it is paid.

Another form of reviewing the landlord’s billing is the lease audit. The lease audit is mostly performed after the tenant has paid the overcharges, and is generally much deeper in scope. Lease audits are usually conducted by third parties that specialize in lease auditing and can be an on-site audit at the landlord office. Again, like the desktop review, lease audits provide significant dollar savings to the bottom line.

Let’s look at 5 frequent areas of overcharges that can be identified in a desktop review:

### Pro-Rata Share

The first item to review is the basic calculation of the tenant’s pro-rata share. The pro-rata share is the percentage of expenses shared by the tenant for expenses incurred for the shopping center or office building. In most leases, the pro-rata share is calculated as a fraction of the tenant’s square footage divided by the total leasable square footage of the shopping center or the building. Be aware that your lease may state “leased” versus “leasable square footage.” If so, the reviewer must now verify all other tenant vacancies and move-in dates. A tenant should never agree to “leased square footage” when negotiating a lease. It is much too difficult to verify and provides the landlord with the opportunity to make a mistake or overcharge the tenant. The tenant’s square footage (numerator) is easy to verify in your lease. However, verifying the shopping center or building square footage (denominator) may be more difficult. Always try the landlord’s website and search on the internet by the name or address of the shopping center or building. Often, this will get you the square footage of the shopping center or building. Asking for a tenant roster with square footages from the landlord is also common. If you are a tenant in an office building and you have a base year, then you should only be paying your pro-rata share of costs over the base year amount in any year. If the base year is a result of the first year’s actual costs, then it is important to review the base year to determine what items are included because it will be used to determine the cost you pay every year going forward.
Now assuming that your retail lease does not allow for anchor contributions, you should be done verifying the square footage that determines your pro-rata share. If your lease allows for anchor contributions, you will need to verify the anchor’s square footage that is deducted, and determine if the contributions that landlord is deducting from the billing is fair. This is done by comparing the cost per square foot of the anchor deduction to the cost per square foot of what you are paying and deciding how big a variance you can live with. Understanding the definition of an Anchor or Major in the lease is also very important. However, if the lease reads “Anchor’s Contributions” instead of “Anchor’s Pro-rata Share,” you may have very little recourse.

**Administrative Charge**

Most commercial retail leases allow for a 5% to 15% administrative charge on expenses to cover the landlord’s administrative cost for the common area. However, over the years, it has become a source of profit for the landlord. Basically, the landlord includes administrative cost in several accounts on the billing and then applies the administrative fee to all expenses including the administrative expenses, thus double dipping. The desktop review should request a general ledger or invoices to identify and disallow these administrative expenses stating that the administrative fee covers these costs. In addition, administrative fees are not always applied to all expenses. Accounts such as insurance, real estate taxes and utilities may not be subject to the administrative fee. In this case the reviewer would just disallow the applied fee on these accounts.

**Non-CAM Expenses**

Many expenses are dictated by your lease language that allows or excludes such expenses. The reviewer will need to read his or her lease carefully to understand which expenses can be billed to the tenant. Some of the more common items are expenses relating to building, structure, roof, capital expenses, initial construction, specific tenants, and landlord professional fees. In addition, if your lease states “expenses for operating, managing, and repairing the common area,” instead of the shopping center, certain expenses related to areas other than the common area may be disallowed.

**Real Estate Tax Review Basics**

Real estate taxes have long been an area where a tenant could expect to find overcharges by the landlord. But the review process was long and cumbersome due to the lack of availability of information. However, in today’s dynamic environment, reviewing real estate taxes has become much simpler. Today this information is much more available due to the increased access of online documents by county tax assessors, tax collectors and the deed of records. Quite often information such as Tax Maps, Property Record Cards and Assessment Values can be found by simply finding the tax assessor’s website for that city or county.

The reviewer should check to see if the tenant is paying for the correct tax parcel. This is easy to do by going to the tax assessor’s website or calling the tax assessor and getting a tax map (also called a tax plot plan). By comparing the tax bill from the landlord with the taxes on the site and tax map, the reviewer can determine if the landlord is charging the tenant correctly. A pro-rata share review as described above should also be performed on the real estate taxes if the tax pro-rata share differs from the CAM pro-rata share.

Another area within the real estate taxes review is abatements (refunds) received by the landlord for the location. Sometimes landlords will receive abatements due to a challenge of the assessed value and receive a check from the assessor for prior periods and forget to pass them through to the tenant. This is verified by calling the tax assessor and asking them if there have been any abatements on the shopping center or building.

Lastly, depending on your lease, late fees or interest charges paid by landlord to the tax collector may be disallowed. These can be detected by comparing the tax collector’s amount on their website to the amount landlord paid or is charging the tenant.

**CAPs**

Often, tenants feel that they do not have to worry about landlord overcharges because their expenses in the lease are capped. Think twice, because there are many ways to be over-billed with a CAP. The tenant’s protection in some cases is less with a CAP than without a CAP because often a review is not performed. For example, if your lease states that in the first year of the term your cost is not to exceed $4.00 per square foot and will increase 5% annually thereafter, the landlord will often charge you the $4.00 per square foot in the first year even if the actual is less. This ripples through the entire term of the lease, overcharging the tenant thousands of dollars. If the lease does not have a stated dollar amount, then the tenant should audit that first year because the entire term of the lease is affected by it. There are many ways for the landlord to increase the amount of the first year to significantly overcharge the tenant in subsequent years.

Understanding the lease is the key to an efficient and effective review. Knowledge of how to review for landlord overcharges is directly related to the amount of savings realized. Tenants that do not have the time to review or feel that they have been overcharged by landlords in prior years, can call companies that specialize in lease auditing to create a review or lease audit initiative.