Lease audit: Optimising occupancy expense savings

Received (in revised form): 19th February, 2023

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Corporate Real Estate Journal
Vol. 13 No. 4, pp. 302–313
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2043–9148

Abstract

This paper provides strategies and techniques for occupiers to capitalise on lease language to minimise occupancy expenses. Identifying ways to reduce occupancy related expenses may significantly benefit organisations' bottom line. Establishing a 'right fit' occupancy cost lease compliance programme is a prudent component of managing a real estate portfolio. The paper discusses techniques in reviewing and verifying that some of the more frequent occupancy expenses have been billed in accordance with the lease. It includes a detailed review of the many facets involved in the calculation of occupancy expenses payable by an occupier, and the ways to validate the accuracy of the expense billing. The paper includes the review of additional lease provisions which if not complied with may result in reduced rent and additional beneficial remedies available for the occupier.

Keywords: co-tenancy, exclusive, character of shopping centre, use provision, common area maintenance, real estate taxes, insurance, utilities

INTRODUCTION

Have you ever considered the time, resources and expenses required for negotiating each lease within a real estate portfolio? Landlords and occupiers alike invest significantly in hiring experienced lease negotiators, often referred to as 'deal makers', to ensure that every provision in the lease is scrutinised for maximum profitability of the leased space. For occupiers, the obligations outlined in each lease represent substantial amounts — ranging from hundreds to potentially

millions of dollars — in occupancy-related expenses, making them one of the most significant costs on the income statement. Managing each lease from an occupancy expense compliance perspective can have a profound impact on a company's bottom line.

Reflect on the numerous lease amendments and modifications negotiated over the past three years. The workforce has been heavily affected by layoffs, retirements and the widespread impact of the COVID-19 pandemic, leading to a need to prioritise tasks with limited bandwidth. This shift in priorities has posed challenges for lease administration for both landlords and occupiers, resulting in a higher likelihood of errors in landlord-billed occupancy expenses.

Now, more than ever, occupiers should carefully scrutinise occupancy expense billings. The key question is when to review expenses: prior to paying the reconciliations or through full audits after the invoices have been paid? The financial impact of the pandemic has made auditing expenses after payment increasingly challenging. Lease audit rights, which are now more restrictive, pose hurdles in obtaining audit information from landlords. Additionally, competing priorities often hinder the timely response and negotiation of settlements after an audit. Landlords may be reluctant to agree to smaller dollar claims, knowing that such claims may not prompt occupiers to seek legal assistance, resulting in many audits remaining unsettled and identified overcharges unrecovered.

Integrating a desktop review process into invoice payment procedures is now more valuable than ever. Landlords are often inclined to cooperate with occupier information requests during the payment process, offering leverage that diminishes once the invoice is paid. Overcharges identified and agreed upon during the desktop review can be offset against the amount due, resulting in a timely reduction in occupancy expenses, preserving the occupier's cash flow.

Many leases require occupiers to remit payments within a specific timeframe from receiving an invoice. Some landlords may enforce this provision to avoid cooperating with billing enquiries. Such responses should signal occupiers to pay as billed, potentially avoiding default and prompting consideration of a full leasehold audit in the future.

The benefits of an efficient desktop review process should outweigh the associated costs. The results may vary based on the language in each lease, making it worthwhile to trial the process with a small lease population to demonstrate its positive impact on the bottom line.

Additionally, alongside the desktop review, many occupiers implement a comprehensive occupancy expense audit compliance programme, which involves exercising audit rights within the lease and conducting an in-depth review of the landlord's books and records. Depending on the size of the lease portfolio and internal resources availability, these reviews and audits can be performed by internal staff or outsourced to external consultants, either simultaneously or independently.

Understanding the potential overcharges uncovered during an audit is a crucial factor when evaluating the overall benefits of lease compliance efforts. Although there are others, the most frequent areas of overcharges include co-tenancy requirements, use and exclusive provisions, common area maintenance, real estate taxes, insurance and utilities. Understanding the areas of concern for each of these lease provisions can assist in evaluating how to establish the right lease compliance review programme for an occupier's portfolio.

CO-TENANCY

A co-tenancy requirement is a stipulation in a lease that mandates landlords to uphold specific occupancy levels or retain certain occupiers within a shopping

centre to safeguard the business interests of occupiers. Failure to meet these requirements may entitle the occupier to various remedies or concessions. In case of a co-tenancy requirement failure, remedies may be promptly available to the occupier, or the lease might specify a grace period, allowing the landlord time to rectify the issue. Some remedies are activated upon formal notice from the occupier, while others take effect immediately.

It is crucial to scrutinise the language in the lease, as co-tenancy provisions can differ, encompassing either multiple or singular requirements. Leases may feature pre-commencement requirements affecting the occupier's acceptance of the delivery of the leased premise or commencement of construction, opening requirements that must be satisfied for the occupier to open and operating requirements that persist throughout the lease term. Some leases, however, may not have any co-tenancy requirements.

Many co-tenancy provisions specify a minimum percentage of the shopping centre or property that must be occupied by open and operating occupiers. Paying attention to the method of calculating this percentage is crucial, considering exclusions such as premises, anchor spaces or named stores. While most provisions are based on the gross leasable area of the shopping centre, some may use the actual number of open and operating occupiers compared to the number of spaces available in the centre.

Certain co-tenancy provisions may mandate the ongoing operation of specific anchor occupiers. The closure of these anchor occupiers could trigger a failure, leading to reduced rent and other occupier remedies. Mall leases often require multiple anchor occupiers to be open, with variations depending on the property's size and nature.

In some cases, leases identify specific 'named stores' that must be open, typically with a minimum number required. These leases may even specify the location of these stores within the shopping centre, ensuring a certain quality and type of co-occupiers surrounding the occupier.

Recent co-tenancy provisions may include language requiring a decrease in the occupier's sales for a co-tenancy failure. Typically, this compares sales for the 12-month period before the co-tenancy period to those during the potential failure period, with a stated percentage year-over-year (YoY) decrease. This requirement adds another level of monitoring and tracking by the occupier needed to validate a co-tenancy failure and invoke the rights and remedies provided in the lease.

Abstracting these requirements and ensuring compliance can be challenging. Some leases necessitate landlords to provide detailed occupancy information upon the occupier's request, while others place the onus on the occupier. Regular review of these requirements is vital, either through internal staff or qualified consultants, given the complexity and potential rent reductions/remedies.

Co-tenancy provision lease language examples

(1) Tenants occupying at least 75 per cent of the gross leasable area of the shopping centre (excluding occupier's premises) must be open and operating.
    Result: Landlord can lease space to any type of occupier (non-retail, schools, churches) operating any days and/or hours to satisfy this requirement.

(2) Retail tenants occupying at least 75 per cent of the gross leasable area of the shopping centre (excluding occupier's premises) must be open for business during normal shopping centre operating hours.
    Result: Preserves the retail purpose of the shopping centre by allowing occupier to add a definition of 'retail tenant' to the lease.

Result: Requires the operation of retailers during hours similar to occupier's store to maximise foot traffic.

(3) Retail tenants occupying at least 75 per cent of the gross leasable area of the shopping centre (excluding occupier's premises and temporary tenants) must be open for business during normal shopping centre operating hours.

Result: Allows occupier to add a definition of temporary tenants to the lease (typically defined as tenants with a lease term of over a year or more) to prevent the landlord from filling the vacant spaces with seasonal occupiers or pop-up stores to meet occupancy requirements.

EXCLUSIVES

Numerous occupier leases incorporate exclusive provisions that afford the occupier specific rights and safeguards, preventing the landlord from leasing space in a shopping centre or project to businesses directly competing with the occupier or engaging in similar activities or services. These provisions aim to safeguard the occupier's market share and competitive edge. The lease explicitly delineates the remedies accessible to the occupier if the landlord breaches this right, encompassing potential rent reductions, lease termination or legal recourse. Proactively examining the co-occupiers within the designated exclusivity area is essential to ensuring the success of the stores and, if violated, can help mitigate the financial impact of competition on the store's sales. In the realm of best practices for lease compliance programmes, it is advisable to abstract and scrutinise these provisions to aid in reducing occupancy expenses.

CHARACTER OF SHOPPING CENTRE OR USE PROVISIONS

To preserve the ambience, attractiveness and cohesive blend of businesses within a shopping centre, numerous leases incorporate character of shopping centre or use provisions. These provisions delineate the permissible business activities for the leased spaces, ensuring alignment with the overall character of the shopping centre and preventing conflicts with the interests of other occupiers or the landlord. The use provisions explicitly define the restricted uses of the leased spaces, encompassing limitations on activities that could create a disturbance or disrupt other occupiers or the shopping centre's operations. These restrictions may involve considerations such as noise, odours or other potential disruptions. In retail or mixed-use projects, these provisions constitute vital elements of a commercial lease agreement.

Many of these provisions stipulate that the landlord must seek the occupier's approval before leasing a space to a business that may violate these requirements. The lease often outlines specific remedies for violations, and a breach may constitute a breach of the lease by the landlord. The diligent review and enforcement of these provisions are crucial for occupiers to maintain the desired occupier mix and uphold the character of the shopping centre that benefits their business. Unwanted businesses have the potential to attract a customer base that does not align with the occupier's business, leading to reduced foot traffic and negatively affecting its revenue. A comprehensive lease audit should encompass the thorough review and validation of these provisions.

COMMON AREA MAINTENANCE (CAM)

Examining common area maintenance (CAM) charges is notably challenging and heavily reliant on the landlord's cooperation. Many CAM provisions are extensive, detailing specific expense inclusions and exclusions. Needless to say, a more detailed audit, whether through a desktop review

or a comprehensive audit, increases the thoroughness and potential for uncovering overcharges. The areas of scrutiny during a CAM audit can be quite extensive.

Before initiating an audit of CAM expenses and other annually reconciled occupancy expenses, the first step is to ensure the accuracy of the landlord's calculations. Surprisingly, even with system-generated reconciliations, there is a possibility of identifying mathematical errors leading to overcharges. Additionally, confirm that the billing period aligns with the lease, as some leases may specify a predefined 'lease year' rather than a calendar year. Check for any periods of reduced rent due to co-tenancy or other lease violations, which might release the occupier from paying certain additional expenses.

For expenses where the occupier shares a portion, verify that the pro rata share is calculated according to the lease. The numerator is typically the occupier's premises' square metres, but the denominator definition may vary. Depending on the type of centre, mall, strip or mixed use, the denominator definition may be extensive and allow for certain spaces to be excluded. Some leases provide for a contribution from excluded space which offsets the expense, while others do not. The denominator may be based on all of the gross leasable area in the shopping centre or the gross leased and occupied area in the centre.

If the denominator is based on gross leased and occupied space, there may be a maximum allowable vacancy level — for example, the language may state the gross leased and occupied area; however, the denominator shall not be less than 90 per cent of the gross leasable area of the shopping centre. Review the landlord's calculations of the minimum denominator square meters. Be sure to scrutinise the definition of the shopping centre and gross leasable area, especially in mixed-use centres with various occupier types such as retail, office and residential. Are the square metres of all of these types of occupiers considered gross leasable area in the shopping centre? Thoroughly review the definitions in the lease, including any exhibits which may be referenced as part of the definition of shopping.

Reviewing the lease's definition of common areas is crucial to determine the areas considered common area under the lease. Ascertain whether the CAM provision only includes expenses related to common areas or if it covers expenses for the entire shopping centre. For mixed use centres, are the expenses related to non-retail occupiers, such as office space, includable in CAM expenses for the store? Another consideration is if the common area includes or excludes expenses related to the building which are leased in the shopping centre. Understanding the layout of the shopping centre and the areas included within the definition of CAM expenses is detrimental in identifying potential overcharges.

Preparing a YoY comparative analysis can highlight expense increases that require investigation. Understanding new expense categories is also essential. Compare the expense categories on the CAM billing to the lease provision and scrutinise the repairs and maintenance provision to confirm which expenses are solely the landlord's responsibility. Requesting a detailed general ledger from the landlord or reviewing actual invoices paid can help validate the expenses included in the CAM billing.

Some leases may prohibit including capital expenditures in CAM expenses, while others permit the amortisation of specific capital expenditures over their useful life. The useful life may be subject to a minimum number of years (ie allow capital expenditures amortised over no less than five years) or may be subject to an accounting standard's useful life policy. In the US, for example, the useful life amortisation period may need to be in accordance with generally accepted accounting policies (GAAP). Verify if there

are limitations on the types of capital expenditures that can be amortised and included in CAM expenses.

Considering the increased outsourcing of property management, it is important to determine whether the lease requires the reimbursement of the landlord's management costs related to common areas or the entire shopping centre. Many leases include language that limits the management-related expenses that may be charged to the occupier. An example is language that states CAM expenses include management and administrative expenses but in no event shall such costs for management and administration exceed 15 per cent of the total CAM expenses. In this example, if the landlord is billing the management/administrative fee at the capped 15 per cent amount, be sure the landlord's actual management fees and administrative expenses exceed this capped amount. Perhaps the actual fees are less than the cap, resulting in a potential overcharge. In many instances not all of the CAM expenses may be subject to the management or administrative fee calculation. There may be certain non-controllable expenses such as utilities and insurance that are not includable in the 15 per cent fee. Scrutinise lease language regarding management and administrative fees to ensure the landlord's billing is in compliance with any specified limits.

Many leases may have caps on CAM expenses, either for all expenses or only controllable expenses, such as landscaping, sweeping and recurring repairs and maintenance. It is less common to have CAM caps on non-controllable expenses such as snow removal, utilities and insurance. Caps on occupancy expenses can be defined in a wide variety of ways. The current year CAM expense due may be limited to the lesser of the current year actual expenses incurred or a fixed percentage increase over the prior year's expenses. This is known as non-cumulative caps. Sometimes the percentage increase is applied to the actual expense due and payable by occupier for the prior year (after the calculation of the cap), and in some cases the percentage increase is calculated by multiplying the total capped expenses for the prior year by the percentage increase before occupier's capped expense amount is determined. Cumulative caps limit occupier's obligation to pay increases in expenses to a certain percentage over the expenses for the prior year determined on a cumulative basis throughout the lease term. The cumulative nature of this cap allows the landlord to recover any unused increases from prior years. Cumulative caps can be cumulative over an initial year at the beginning of the lease term (year over base year cumulative) or YoY cumulative, which differs from the year over base cap in that the cap percentage is applied to the prior year's expenses and not the original starting year's expenses. Retroactively reviewing cap calculations from the lease's inception is an audit best practice.

Even if the lease does not mandate payment of a proportionate share of CAM expenses, there may still be potential for overcharges. Leases with fixed CAM charges should be carefully reviewed to confirm that other expenses paid on a proportionate share basis do not include common area expenses. Validate any fixed CAM increases to ensure compliance with the lease terms.

CAM provision lease language examples

(1) CAM means costs paid by landlord for operation, maintenance and repair of the common area and supervision thereof (but in no event shall costs for supervision, management and administration in total exceed 7 per cent of the CAM expenses).

Result: Reimbursable costs must be paid by the landlord, ensuring this is a reimbursement provision.

Result: Supervision, management and administration costs cannot exceed 7

per cent of the CAM expenses. If landlord's actual supervision, management or administration expenses paid are less than 7 per cent, landlord should include actual expenses paid in the billing as opposed to billing at the higher amount calculated at 7 per cent.

Result: CAM includes cost related to the common area in the shopping centre, not the entire shopping centre.

(2) Operating costs means the aggregate of all costs and expenses incurred by or on behalf of the landlord for ownership, operation, maintenance, repair and management of the shopping centre.

Result: Costs reimbursable are for the entire shopping centre and ownership costs, as opposed to only the common areas. Without a definition of 'ownership' costs the landlord may include their home office and other indirect non-shopping centre-related costs.

Result: No limitation on management costs. Landlord can include management payroll and a management fee.

(3) Increases in CAM expenses after the first full calendar year shall be limited to 5 per cent annually.

Result: CAM expenses cannot increase more than 5 per cent over the prior year's CAM expenses. The calculation in Figure 1 details this calculation based on the occupier's share of expenses at 25 per cent.

(4) Increases in CAM expenses after the first full calendar year shall be limited to 5 per cent of the capped common area costs payable by tenant for the previous year.

Result: CAM expenses are limited to 5 per cent of the CAM expenses paid by the occupier the prior year. This is more advantageous to the occupier than example 3, since the cap is based on the actual costs paid, which may be less than 5 per cent of the actual CAM costs for the prior year as the lease progresses. The calculation in Figure 2 details this calculation based on the occupier's share of expenses at 25 per cent.

(5) The annual increase in CAM expenses during the term, beginning in calendar year 2020, shall not exceed 5 per cent of the CAM expenses charged to tenant from the prior calendar year (cap). If CAM expenses increase by more than the cap in any given year, landlord may carry over the difference to another year, so long as CAM expenses billed to occupier never increase by more than the cap on an annual cumulative basis over the term; if CAM expenses increase by less than the cap in any given year, landlord may carry over the

Example 3: CAM Cap – 5% Annual Increase	2020	2021	2022	2023	Total Paid 2020–2023
Actual CAM Expenses	$ 100,000	$ 112,000	$ 115,000	$ 108,000	
Occupiers's Share @ 25%	$ 25,000	$ 28,000	$ 28,750	$ 27,000	
CAM Cap – 5% Annual Increase over prior year actual expenses		$ 105,000	$ 117,600	$ 120,750	
Occupiers's Share @ 25%	$ –	$ 26,250	$ 29,400	$ 30,188	
Amount Due to Landlord	**$ 25,000**	**$ 26,250**	**$ 28,750**	**$ 27,000**	**$ 107,000**

Figure 1 CAM cap — 5 per cent annual increase

Example 4: CAM Cap – 5% over CAM expense paid by Occupier the previous Year	2020	2021	2022	2023	Total Paid 2020–2023
Actual CAM Expenses	$ 100,000	$ 112,000	$ 115,000	$ 108,000	
Occupiers's Share @ 25%	$ 25,000	$ 28,000	$ 28,750	$ 27,000	
CAM Cap – 5% over CAM expense paid by Occupier the previous Year		$ 26,250	$ 27,563	$ 28,941	
Amount Due to Landlord	**$ 25,000**	**$ 26,250**	**$ 27,563**	**$ 27,000**	**$ 105,813**

Figure 2 CAM cap — 5 per cent over CAM expense paid by occupier the previous year

unused portion of the cap to another year, so long as the CAM expenses billed to occupier never increase more than the cap on an annual cumulative basis over the term.

Result: The 2020 CAM expenses are the basis for the cap for the entire lease term. The tenant may not receive benefit of decrease in expenses if during the term expenses in years exceeded the cap and were 'banked' for subsequent years. The calculation in Figure 3 details this calculation based on the occupier's share of expenses at 25 per cent.

Example 5: CAM Cap – 5% cumulative Cap, 2020 base year	2020	2021	2022	2023	Total Paid 2020–2023
Actual CAM Expenses	$ 100,000	$ 112,000	$ 115,000	$ 108,000	
Occupiers's Share @ 25%	$ 25,000	$ 28,000	$ 28,750	$ 27,000	
Cap Amount – 105% of 2020 increased 105% each year thereafter	$ 100,000	$ 105.000	$ 110,250	$ 115.763	
Occupiers's Share @ 25%	$ 25,000	$ 26,250	$ 27,563	$ 28,941	
Amount Due to Landlord	**$ 25,000**	**$ 26,250**	**$ 27,563**	**$ 27,000**	
Carryover	$ –	$ –	$ –	$ 1.941	
Amount Due to Landlord	**$ 25,000**	**$ 26,250**	**$ 27,563**	**$ 28,941**	**$ 107,754**
Carryover – amount in excess of Cap:		$ 1,750	$ 1,188		
Carryover Applied				$ (1,941)	
Cumulative Carryover		$ 1,750	$ 2,938	$ 997	
Annual Cap Amount	$ 100,000	$ 105,000	$ 110,250	$ 115,763	
Cumulative Cap Expenses		$ 205,000	$ 315,250	$ 431,013	

Figure 3 CAM cap — 5 per cent cumulative cap, 2020 base year

Conducting an audit of CAM expenses requires a high level of scrutiny and thoroughness. The example lease language provided demonstrates how changes of a few words in a provision can affect the occupier's portion of expenses owed to the landlord under the lease.

REAL ESTATE TAXES

Ensuring that the real estate tax has been billed in accordance with the lease terms can lead to substantial savings in occupancy expenses. While calculating taxes under the lease may seem straightforward for most occupiers, there are critical areas to scrutinise to validate that an occupier is indeed paying the taxes negotiated in the lease.

When reviewing the tax clause, ascertain whether the tax reimbursement is based on the taxes paid by the landlord during the lease term or those assessed for periods within the lease term. Consider that taxes in certain jurisdictions are paid either in advance or in arrears. Understand the tax year for each real estate tax billed and the frequency of payments, which varies based on the laws of the individual tax jurisdiction.

Tax reimbursements should correspond to when the landlord made payments, possibly entailing a discount for early payments. As an occupier reimbursing real estate taxes, it is crucial to obtain evidence from the landlord regarding the amount and date of tax payments. Most leases do not obligate occupiers to reimburse landlords for penalties and interest resulting from late payments, so confirm that such amounts are not included in the tax expense.

Similar to the review of CAM expenses, conducting a YoY comparative analysis is advisable to identify changes in tax billings. Prepare a summary listing of parcel/account numbers and related assessment values for a quick verification of correct tax bills from the shopping centre. Ensure the summary includes references by state, county, building, parcel/account number, tax type and assessment values.

Understanding the designated area for real estate tax reimbursement under the lease is crucial. Attempt to obtain an updated site plan indicating all buildings and their respective square meters. Review the lease to determine if the occupier is obligated to reimburse taxes for the entire shopping centre or only for the tax parcel where the store is located. Once the area for tax expenses is determined, most tax assessors have tax parcel maps available on the Internet, which detail the buildings and improvements assessed on each tax parcel. Reviewing the parcel map(s) will help to ensure that the occupier has received all the real estate tax billings applicable to its share of the taxes.

Compare the tax parcel maps for the parcels included in the tax billing to the shopping centre buildings and areas reimbursable under the lease to verify the occupier is paying taxes on the appropriate areas in the shopping centre. This review may identify tax parcels billed for which taxes are not reimbursable under the lease. In addition, the parcel maps will indicate if the centre is taxed on one parcel or on multiple parcels. The landlord may be excluding parcels with separate assessments and/or tax parcels from the billing. Be sure to review if the separately assessed tax parcel includes a portion of the car park attributable to the building or if it only includes improvements (building). If the assessment only includes the building, how is the landlord billing for the land taxes (taxes under the buildings and car park)? Review the lease language to confirm if separately assessed parcels can be excluded and if the lease provides for a separate calculation of improvement and land taxes.

Determine the appropriate calculation for the share of taxes under the lease, whether it is based on the store's square metres divided by the entire shopping centre's square metres or specific to the tax parcel the store occupies.

In instances where the occupier only pays taxes on the tax parcel the store is located on, it may be the store's square metres divided by the square metres of all the improvements on the tax parcel. Most tax assessors publish property tax record cards that detail the square metres measurements by building of all the improvements on the tax parcel. Comparing this information to a site plan of the centre and the lease will help validate the accuracy of the denominator used to calculate occupier's share of the taxes.

Once the validation of the tax period and shopping centre area for the tax obligation is complete, review the actual taxes and assessments included in the bills. Check if the lease definition of taxes includes special assessments such as sewer charges or development bonds. Landlords have been found to charge significant development costs to the occupiers in the form of 'special assessments'. This occurs when, during the approval process for the shopping centre, development costs normally paid by the landlord in their mortgage for the shopping centre are segregated and financed separately. The landlord then negotiates with the local government authority to have these costs paid by a special assessment. Known examples are ring roads, highway interchanges, access roads and parking structures. Special assessments may represent significant development costs transferred to occupiers, so be sure the lease definition of taxes includes the reimbursement of these costs.

While reviewing the tax expense, confirm that all included taxes are real estate taxes as defined in the lease. Some leases may require payment of both real estate and personal property taxes. Ad valorem taxes, typically levied on both real estate and major personal property, are usually based on assessed property value. Monitor YoY assessed values for any decreases and inquire with the tax assessor about successful appeals and potential retroactive refunds or credits. Confirm that the landlord has repaid the occupier's share of these refunds, including any interest. Additionally, check if the lease requires reimbursement for expenses or legal fees incurred during the tax review.

Implementing these recommendations equips an occupier with the tools to thoroughly evaluate its real estate tax billings. Whether conducting a desktop review or a comprehensive audit, a meticulous examination of real estate tax obligations is an integral aspect of confirming lease compliance.

INSURANCE

Property losses resulting from recent natural disasters have significantly affected insurance rates. Events such as heavy rains, hurricanes, tornadoes and floods have led to a surge in both the number and severity of insurance claims. It is crucial to comprehend insurance costs and how these expenses are transferred to occupiers. The starting point is a thorough review of the lease. Ideally, insurance cost provisions should be articulated in language that explicitly outlines the obligations between landlord and occupier, along with how these costs are allocated to the occupier.

Typically, two distinct types of insurance may be transferred to occupiers: property insurance, which reimburses the landlord for any damage or destruction to its buildings and physical plant; and liability insurance, which provides coverage for the landlord (and occupier) in case of loss in a civil suit arising from an accident, injury or other types of loss.

The key lies in understanding the specifics of what insurance policies the occupier is paying for. Determine if the lease's insurance obligation exclusively covers common area liability or extends to the entire shopping centre area. Clarify whether the insurance obligation is billed as a separate cost item or included as a CAM expense. In either case, request relevant financial documentation related to the invoice. Obtain copies of the premium notice and schedule, showcasing

the designated premium amounts for the building, along with a copy of the invoice from the insurance company. Ensure to obtain a copy of the declaration sheet for the occupier's building to confirm the types of insurance policies the landlord has for the building and the coverage they provide. If a landlord holds a blanket insurance policy covering other buildings and shopping centres it owns, there is a potential for unfairly allocating more of the insurance cost to the centre where the store is located compared to its other properties. Therefore, it is imperative to identify precisely how the insurance bill was allocated among the landlord's various properties. Compare these documents to the language in the lease.

Preparing a per-square-foot insurance cost history of other stores located in the same geographic area is a helpful benchmark in validating the reasonableness of the landlord's costs. For instance, if an Ohio region typically experiences insurance costs ranging from US$0.15 to US$0.25 per square foot, finding the landlord charged a similar amount would likely indicate a reasonable charge. If, however, an occupier in the same area encounters a per square foot cost of US$0.85, it raises a red flag, necessitating a closer examination. Location significantly influences insurance costs, with regions such as California or Florida likely to have higher casualty premiums due to elevated risks such as earthquakes, wildfires and tropical storms. When preparing a comp analysis, ensure each property's insurance includes the same policies and coverage.

Conducting a detailed audit of the landlord's invoices and comparing them to the lease language is a prudent practice. Overcharges may stem from costs related to insurance policies not reimbursable under the lease, errors in proportionate share calculations, or inequitable allocation of blanket policies. A thorough review of insurance billings presents an additional opportunity to potentially reduce occupancy expenses.

UTILITIES

In addition to insurance, other occupancy expenses such as premises-related utilities and waste should be subject to review. Many larger occupiers directly pay these charges to providers, minimising concerns about overcharges. Scrutinise the lease to confirm whether it obligates the occupier to use landlord-provided services. Examining charges for landlord-provided utilities or waste can be beneficial to the occupier's bottom line.

For waste removal services, review the lease to ascertain whether it is included in CAM or billed separately by the landlord. A practical test for potential overcharging is comparing the cost per square foot for the landlord-billed store to that of stores where the occupier directly pays waste providers. If there is a significant variance and the billed charges by the landlord are considerably higher, contact the landlord to understand if the level of services provided is excessive or if the occupier is sharing waste charges with other occupiers generating more waste than the occupier's store. If the lease permits, contracting service directly from an outside provider might be a viable solution, potentially leading to cost reduction. Partner with the landlord to determine if there is a way to reduce the occupier's share of these costs.

In many leases, occupiers are required to pay the landlord for the electricity used to operate the store. Lease provisions concerning electricity charges are often intricate or unclear, and the methods for allocating electricity use and determining rates vary substantially. Occupiers are sometimes charged for more electricity than they use and at rates higher than what the landlord paid. Lease provisions governing how the landlord determines the amount of electricity used by the occupier and the rate charged for each unit of energy should be carefully examined. Clarity is crucial, and even if the language is vague, occupiers have a strong argument that the landlord must

use a rational basis to determine usage and cannot simply speculate.

Exploring lease provisions regarding installing meters and auditing rights for electricity calculations is vital. The lease may allow the occupier to install a meter, and it may require the landlord to provide evidence of applicable rates, the basis for the electricity calculation, notice of changes in assumptions, or information about the energy management system at the centre. These provisions are critical for a factual investigation into the validity of electricity charges and create leverage for the occupier in negotiations with the landlord.

Occupiers should investigate the rates charged by the landlord to evaluate whether they align with the lease terms. Ideally, occupiers should obtain information directly from the landlord, including high-volume and low-volume rates, as well as rates varying by the time of day and demand levels. Other landlord-billed utilities, such as water, sewerage and gas charges, should undergo similar scrutiny, starting with a per square foot analysis of other stores in the geographic area. Request additional information from the landlord to understand charges and allocation methodology, always considering the lease language and collaborating with the landlord on potential cost reduction strategies.

CONCLUSION

In summary, the advantages for occupiers in conducting lease audits significantly surpass any potential drawbacks. By comprehending and upholding the stipulations of the lease, occupiers gain confidence that landlords adhere to the intricately negotiated terms and obligations. The various lease clauses discussed in this paper underscore the complexity and depth of lease negotiations, as well as the potential for billing inaccuracies. Thus, it is wise and prudent for occupiers to minimise financial risks by instituting a lease audit or review procedure to ensure their occupancy costs remain accurately represented.