

# LEASE AUDIT **REVIEW**

THE NEWSLETTER OF THE BDO CORPORATE REAL ESTATE SERVICES PRACTICE



## OUTSOURCING LEASE ADMINISTRATION: ARE LEASE AUDITS BEING PERFORMED PROPERLY?

By David Tevlin

The outsourcing of real estate functions by Corporate America is increasingly common and shows no sign of slowing down. Both major and mid-level corporations increasingly are considering contracting out many or most of their core real estate related activities, including overall facility management, building and operational supervision and such other internal processes as portfolio and lease management implementation and lease administration and auditing.

The rationale for the outsourcing trend is the desire to have outside professionals offer their expertise in these matters, while reducing the need for permanent staff in the corporation.

The major national real estate service providers, which include brokerage,

management and consulting firms, have moved to satisfy the demand for their services by offering a full service menu under a single roof. Many now offer in-house facility management that includes overall operational cost control supervision, beginning with strategic planning and ending with portfolio and lease management. This is an admittedly appealing concept and the "One stop shopping" approach appears to have no end in sight.

To date, matters appear to be running fairly smoothly although the jury is still out on the overall cost/benefit ratio from the outsourcing of these services. Most corporations do seem to be receiving an increased level of information and services that either were not performed at all or were performed at much lower level of expertise.

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# THE SOFTWARE SELECTION PROJECT

By Jeffrey Tosello

So, either you have volunteered or have been requested to investigate finding some way to better manage real estate information and are ready to spend a few hours on the web researching the latest lease administration software. Great; the organization thanks you! Now get ready for six months of confusion, high tech jargon and service provider slight-of-hand.

Entering the words "lease administration software" in MSN's search engine produces 652,824 responses. Using Google it produces over 11 million!

## ►GETTING STARTED

The process of finding something to replace the old spreadsheet or "home grown" database can indeed be daunting and subject you to months of information gathering, web-based demonstrations and RFI/RFP responses that will make you dizzy, leading you to some of the first logical questions:

*"Does anyone have a simple matrix of the more commonly used applications that I can get my hands on to narrow the field a bit?"*

or

*"Is there a provider that can help us sift through all of this and just tell us what the best application is for a company like us?"*

## ►SUSPICIOUS MINDS

While it would seem that there are equally logical answers to these questions and the market professes to offer solutions to both, the source of the answer should be carefully considered.

If the provider of the matrix has a particular orientation toward a given product (because they have a financial incentive with any of the companies) their information has to be appropriately suspect. If the provider professing to tell you which software to use does not know much about your company or business objectives there is no way they would

be able to suggest the appropriate tool for you to use. For that matter, they may actually benefit by leading you down the wrong path or to an entirely different approach toward a business service they provide. The reality is that there is no way to avoid going through some of the groundwork yourself in order to select an appropriate product and find an appropriately matched tool.

## ►LOGICAL FIRST STEPS

The good news here is that this process does not have to be painful, time-consuming or (surprise) overly technical. Further, the time and energy spent going through this process will substantially increase the likelihood that this effort will be successful and cost-saving to the organization.

**(See Tips for Getting Started)**

This article is not to say that at some point your IT group will not want/need the technical data on the software or that your organization may not impose certain data security and protection protocols but, the prevailing software companies that are out there have already satisfied some of the largest companies in the world with this information. As such, it is best to approach this as an information user first and let the "techies" get involved later.

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## THE SOFTWARE SELECTION PROJECT

### ▶SOFTWARE IMPLEMENTATION PARADOX

The manner in which the software companies describe, demonstrate and sell the applications can be misleading (intentionally or inadvertently) to the customer. The longer, more complicated the implementation, the more it costs you (earns fees for them). Giving them the benefit of the doubt, many customers don't know what they want or the right questions to ask and so they get the canned sales pitch.

### ▶THE FINISH LINE

Steven Covey, recognized author of *The Seven Habits of Highly Effective People*, had it right when he told us to begin with the end in mind. The beginning starts with an understanding of the desired ending result(s).

It starts with understanding the organizational goals, how the people that will collaborate by contributing or extracting data and information to/from the software tool will relate to each other and how the organization as a whole will define success in terms of what this new tool is to provide.

Having specific information about these "ends" will help reduce confusion and sharpen potential software provider answers, leading to an easier selection and implementation process.

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## OUTSOURCING LEASE ADMINISTRATION

### ▶AN IMPORTANT EXCEPTION

A significant area where this may not be happening has to do with escalation cost reviews. Often times a superficial review is performed (sometimes referred to as a "desk audit") that does not include an actual on-site inspection of the landlord's books and records (the practice generally known as a "field audit").

This practice of performing only a desk audit significantly diminishes the potential cost savings opportunities that should be realized by corporate tenants. Maximizing cost savings can only be achieved when independent, professional, and experienced firms perform the lease audits, including a field audit.

Another pitfall is that many firms will outsource the actual lease audit to the lowest bid sub-contractor, which fails to assure that the work will be done properly.

### ▶CONFLICTS OF INTERESTS

Corporate real estate executives may wonder why anything is wrong in retaining a brokerage firm for performing a lease audit. The simple answer is that with few exceptions, most major real estate brokerage firms also manage buildings.

Conducting lease audits of these buildings create a clear conflict of interest for the brokerage firms, who wear two hats. First,

they sit with landlords in administering and rendering operating expense charges; second, in other circumstances they seek to perform a lease audit that questions the overall accuracy and validity of such charges. While the real estate brokerage firms can assert that these two competing functions are performed independently by separate sectors of the company, this certainly can be questioned and raises a credibility issue. The major function of the brokerage firms is to assist both landlords and tenants in negotiating real estate leases and provide property management services to owners. Any activity other than this inevitably will take second place or will be subcontracted out to others, as already noted.

Real estate brokerage/management firms understandably are hesitant about alienating the landlords who provide the bulk of their commission income. In fact, not until Corporate America seriously began inquiring about lease audit expertise that such services were actually offered by brokerage firms. However, the absence of a properly conducted lease audit will seriously diminish value of any desk audit. This is particularly significant in the current market place, where office buildings are incurring significant increases in overall expenses. It is essential that operating costs be verified for accuracy and proper allocation in accordance with lease provisions.

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## HERE IS A (PARTIAL) LIST OF TIPS TO HELP YOU GET STARTED:

### Information to Gather Up Front:

- What spreadsheet or database data fields do we need to capture? Are there others we would like to capture?
- What type(s) of reports would we like to generate?
- Who will be using the system? What is their level of technical competence?
- Are there data or network security policies on what we can or cannot use?

### Questions to Ask Software Providers:

- What can the application do straight out of the box versus with customization?
- What components or modules are "sold separately"?
- What resources will the company provide to me to help with the setup? What do those resources cost?
- What references can you provide of users that have deployed the application in a manner similar to our company?

### Key Success Factors for Implementation:

- Generating a Thorough Request Letter to Decentralized Operations (assuming information and documents need to be gathered from remote sources) and that Communicates Process Expectations After Implementation.
- Documenting Common Procedures and How They Effect or are Supported By the Software.
- Developing a Standard "Reporting Cycle" that is Reconciled Monthly and that Ties to the "Accounting Processes" **This is Required for Sarbanes/Oxley Compliance!**
- Measuring the Results Against Stated Goals Developed Before the Project.