



2020 LEASE AUDIT SPOTLIGHT: ASSESSING THE COST OF AMENITIES

LEASE AUDIT CASE STUDY: AMENITIES

A commercial office tenant moved out upon its lease expiration, which left half a floor vacant in the building. The landlord spoke to its major tenants and proposed installing a gym and tenant lounge in that space for them to use free of charge. The local representatives of those tenants agreed, but there was no specific discussion of how the costs associated with operating and maintaining the space would be treated—or that the costs would be included in the building's operating expenses.

However, at least one tenant's lease stated that the cost of any tenant amenities was specifically excluded from operating expenses. That organization's corporate real estate department was not even aware of the landlord's proposal until after the gym and tenant lounge were constructed and operational. The costs came to light only after an operating expense audit was conducted. The audit showed more than \$1 million of imputed rent and operating costs for the gym

COMMERCIAL TENANTS NO LONGER AMENABLE TO COMMON AMENITY SPACES

By the beginning of 2020, amenities had become a popular trend in commercial office buildings. Fixed space amenities (such as fitness centers, tenant lounges, rooftop spaces and conference facilities), as well as curated services (such as restaurants, childcare, valet parking and organized “tenant-only” events), improved the workplace experience for tenants and their workforce. It also made the building more desirable for prospective tenants and, therefore, more competitive in the marketplace. So, amenities offered a benefit to both landlords and tenants. Many new construction properties included purpose-built spaces for popular amenities. Landlords in older buildings invested in new furniture for lobby activation, and they renovated or retrofitted existing space to add amenities and enhance common areas.

The COVID-19 pandemic upended those trends, leaving many office spaces empty and amenities unused for months on end. The crisis has also precipitated a shift in tenants' desires for amenities. These unforeseen changes highlight the urgency and lasting benefits of conducting a 2020 lease audit.

- ▶ Previously, the question was: Who pays for amenities, and how are costs passed through?
- ▶ Now, the question is: What will landlords do with underutilized amenities, and will those costs be eliminated, adjusted or continue to be passed through to the tenants?

As shown by the case study above, it's critical to examine lease language regarding amenities and gain full visibility on the specific details about any changes.

As landlords and tenants assess the road ahead for corporate real estate, agility and flexibility are more important than ever. Conducting a 2020 lease audit may provide the insight to help those charged with evaluating future needs make informed decisions about how to increase agility for both the near term and long term, and potentially unlock significant cost reductions.



TENANTS' NEEDS AND DEMANDS ARE SHIFTING

As where we work and how we work have changed, many organizations have adjusted their workplace and workforce strategies. The pandemic has only accelerated those shifts. Most office tenants will likely have fewer workers on site for the foreseeable future. The wider adoption of remote work and hybrid work models during the pandemic will also trigger lasting changes, fragmenting the previous model of a company headquarters. One emerging trend is the hub-and-spoke model—a central office with decreased headcount and density serving as the hub with smaller satellites in the area to house specific teams or functions.

Currently, most office building amenities likely haven't been used for a year, and it's unclear when they will be desirable again, if ever. Some previously popular amenities that may no longer be desirable for tenants include:



Locker rooms with showers



Eat-in cafeterias



Lounge spaces



Game rooms

Consider the case of a tenant who entered into a new lease in 2019 with the intent of using an array of building amenities, the costs of which are listed in the lease agreement as allowable operating expenses. Now fast-forward 18 months, and the tenant's employees are working remotely for an undetermined amount of time. Should the tenant be required to pay for amenities that will not be used? This is clearly a situation that requires a conversation between the landlord and the tenant.

The types of facilities and amenities in demand will be different—and fewer—going forward. Health, safety and wellness will be increasingly important priorities. Enabling comfort and facilitating productivity for staff will continue to be key goals, but the ways those are achieved have shifted. Future in-demand facilities will potentially include:



Mixed-use, multipurpose conference and collaboration space



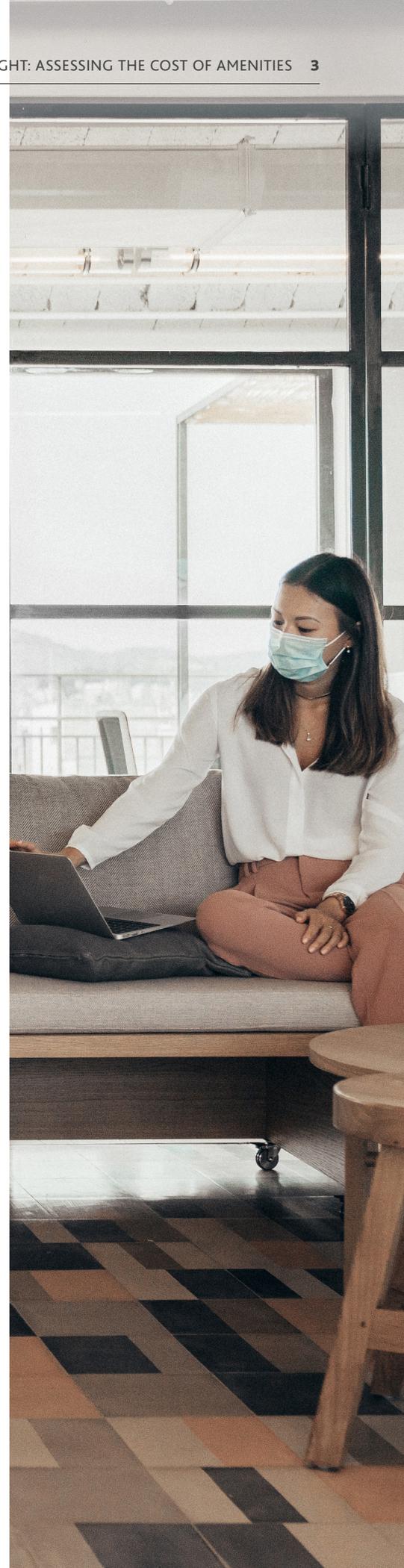
Private spaces or nooks for focus work or relaxation



Activated outdoor areas

Although the need for outdoor and open-air spaces will be in higher demand, the practicalities of using such spaces will vary depending on geographic region, climate conditions and other factors.

Technology solutions that enable remote work have also changed the need to commute. Workers now have more flexible work schedules and easier access to amenities near the home, so there will be less of a role for commercial landlords to provide those amenities.



LANDLORDS ARE ADJUSTING ACCORDINGLY

Landlords aim to provide what tenants want in order to increase leasing momentum and renewals. Previously, landlords may have converted unleased office space into shared building spaces and amenities, but now that demand for amenities has declined, landlords will pivot. It's critical for tenants to understand the details of those adjustments.

Changes in the types of amenities being offered will affect operating expenses. For those amenities that remain, tenants need to understand the details of how the costs are treated to make sure that treatment is consistent with the applicable lease language.

Tenants need a comprehensive understanding of all operating expenses being charged to them, especially in light of the considerable upheaval during 2020. Obtaining complete records of the landlord's operating expenses can help achieve that understanding. It may also be possible to agree upon a comprehensive list of amenities that are advantageous to maintain, and those which are no longer desirable. Transparency about any changes to costs, equipment and services helps all concerned parties and maintains a productive dynamic.

AGILITY FOR THE FUTURE

It's more important than ever for businesses to foster agility and flexibility in their corporate real estate strategy. In order to address those areas, tenants need a complete understanding of the expected costs over the life of the lease. Having an expert consultant review the lease can help gain a more accurate picture of the costs and expenses being passed through, and identify aspects that need to be clarified or restricted with additional language. With greater transparency and visibility about their lease and associated costs, organizations can increase agility and chart the path forward.

[Learn more](#) about how lease auditing can help bring clarity to changes in building amenities and your responsibility for paying the cost. You can also consult our checklist: [Are You Prepared for a 2020 Lease Audit?](#)

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