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What is Lease Administration? And Do I Really Need It?

This has always been one of my favorite topics relative to commercial real estate. Not because it is particularly fascinating, but because it is often so misunderstood. Ounce-for-ounce, lease administration can have a powerful impact on users of real estate and landlords/REITs alike. Lease administration done properly is the super-food of CRE.

Let's start by defining lease administration. This is what Wikipedia has to say:

"**Lease administration** *is a department that usually falls under an organization's real estate department. Lease administration involves receiving rents from facilities they own and paying rent for the facilities they lease, and other activities. It has become an integral part of the accounting, administrative, and legal requirements normally associated with a real estate portfolio. Job responsibilities for lease administrators and real estate professionals include: lease review and abstracting, accounting and processing, lease audits, CAM charges, lease renewal options, repairs and maintenance, information management and reporting, occupancy cost analysis, operating expense review, and document storage and maintenance. Once a lease is in place, lease administrators continue to manage and monitor rental payments, coordinate any tenant alterations, and handle lease amendments when necessary.*"

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Not a bad definition. I concur with every word. It represents the blocking and tackling of the CRE lease world. But we all know that blocking and tackling not directed at either scoring a touchdown or preventing one is, well, just a good workout. Jumping to another metaphor, it's like having a pantry full of great ingredients, but until we cook something, we don't yet have a meal. We have to organize and manage the lease data in a way that allows us to make better decisions, not just oversee a past action.

With that said, allow me to offer my own definition of lease administration:

Lease Administration is the ongoing process of gathering key business and legal points from leases to ensure contract adherence (the past) and applying these data points into meaningful metrics to predict and standardize better utilization of real estate (the future).

My definition is a fancy way of saying make sure you do what you contractually agreed to do, but also take the data you've collected to help make your real estate more valuable, better utilized, and with less risk. All too often the lease abstracting and lease administration process takes a "let's see what we just did" approach rather than producing measurable proof of what we intended to do.

Lease administration should be living. It should be a learning benchmark to identify and create standards. It should be tool that allows decision makers to recognize potential problems as well as opportunities. It should be one of the primary strategic filters for planning, budgeting and forecasting. If lease administration falls short of this, then it is just blocking and tackling and lacks meaningful purpose.

Corporate users (occupiers of lease space) should use lease administration to analyze how their space is utilized by their employees and where underutilized space exists. Division A of a company may need to downsize in a given market while division B needs to expand and could use the space that is already being paid for rather than leasing additional space. Employees, key vendors and client locations should be tracked relative to existing locations. Maintenance responsibilities that may have been overlooked in prior lease negotiations should be used to create standard checklists for future leasing. Perhaps there is a strategic reason to have one or more leases be coterminous, even if they're in different markets. There may be a regional or national REIT/landlord who has proven negligent or hard to work with. An integrated lease administration system would help avoid that landlord in the future.

Landlords should use lease administration to manage tenant-mix and potential exposure of tenant defaults. Too many tenants serving the same industry could prove disastrous if that market experiences a downturn. The oil and gas industry is a current example of this. Conversely, leasing agents should use the information tracked via lease administration to identify strategic potential tenants. How many times has a leasing agent and owner unknowingly leased space that had a First Right of Refusal or First Option tied the suite? What about tenants who may be expanding beyond the space limits of a property? There may be an opportunity to relocate them or purchase a building in exchange for a long-term lease. Why are some properties performing better than others? The benchmarking and learning opportunities are nearly infinite.

In the following section of this paper, I am going to expand this discussion to cover who really needs to employ lease administration, and identify some of the basic principles guiding a truly effective lease administration system. The main point I hope I've conveyed thus far is this: lease administration is a whole lot more than tracking rent, size and expiration dates. Every lease is a learning experience for an organization. A well thought-out lease administration system puts these lessons to work.

Do I really need lease administration? A realistic look at the basics of CRE property and lease administration:

The short answer is: if you don't already have a lease administration system in place, then no you don't. Obviously, life has gone on and operations are humming along without one. But if you have ten or more leases, then yes, you *should* have a lease administration system.

But before we dive into the "whys", let's Ask: When does Lease Administration software become mission critical? After 20 years of designing applications to manage leases, here is my breakdown:

<u>1-5 leases</u>: not mission critical.

<u>6-10 leases</u>: a should have, but not mission critical

<u>11-15 leases</u>: a definite need, but life will go on without it

<u>16+ leases</u>: Mission Critical

Let's focus on the corporate user or tenant of leased locations. If you're a Fortune 500 company with hundreds of locations around the country or world, you should already have well-structured lease data and processes in place to manage your leases. However, if your company is like thousands of others that have just a few leased locations spanning up to dozens, this article is specifically for you.

Most authors of blogs and articles like this one would immediately break into the litany of value buzzwords such as efficiencies, NOI, streamlining and cost savings. I'm not going to do that. I'm assuming you already know or at least have inferred from the title of the article that I am a big believer in well-placed lease administration. Instead, I am going to talk about basic organization and risk management, in this case more appropriately referred to as "CYA."

I read an article many years ago profiling Larry Ellison, founder and CEO of Oracle. He told a story that struck me as profound in its simplicity. He reflected on a routine morning in his office preparing for a meeting with his assistant. One of the items he needed was a report showing the total number of Oracle employees. His assistant offered to get with HR and Finance to produce the report. Ellison replied that he wanted to just generate the report himself and was shocked to realize he couldn't access the information, as there was no comprehensive database of employees. The data he needed resided in unknown numbers of individual databases. His quote to sum up the situation was something like "You mean to tell me I'm the founder of the world's largest database company and I can't even generate a report of my employees?!" It is absolutely amazing how many CRE executives I've talked with over the years who can't even produce a simple list of all their locations. No one can manage what they don't have control of. This is why getting organized is so vital.

Lease administration, at its core, boils down to organization and risk management. There are many additional benefits going well beyond these two core points, but for now I'll stick to basics. Organization is about developing a system to track lease data that is consistent across all leases. I use the word "consistent" because all too often, companies will abstract lease documents with no framework of key terms they've identified as important. This allows important information to be missed and superfluous data to be included. The lease abstract framework is like a recipe that ensures you gather the necessary ingredients from the lease document. As we all know in CRE, every lease is different and it is important to know what we're looking for, so we can organize the data thoroughly and consistently to ensure contract adherence is maintained.

To illustrate this point, a few years back my firm (Quarem) completed a contract to provide our lease administration application to a large Fortune 100 company. They had approximately 350 leases all over the world and nearly all of them needed to be abstracted. So they contracted with an outside firm overseas to abstract the leases and enter the data into our software. They did this with no predefined framework or standards of what data they wanted in the system. The result was absolute data chaos. There was no consistency and seemingly simple elements like "lease term" and "location" (among many others) were entered incorrectly, in the wrong place, or not at all. Their portfolio was haphazardly organized and reports were useless. What took three months to mess up, took nearly nine months to correct.

As you can see, even large, sophisticated companies make the mistake of underestimating the complexity and importance of organizing their portfolio and data. So many business leaders instinctively view abstracting leases as being akin to reading a book and simply writing a book report or Cliff Notes of the lease. But I assure you that if I gave the same lease to five different people, I would get five different abstracts. Developing a defined framework of key terms is the foundation for consistent and useful organization.

We've covered the importance and theory of good organization; now let's talk about the real world and why we need lease administration. I'll facilitate this via hypothetical Q&A. Consider these questions:

1. Could you produce a reliable list of every location your organization leases or owns from a single data source? Can you do this right now from anywhere in the world?

2. Can you retrieve any lease document, proposal, floor plan or other file for every location?

3. Do you remember every lease expiration, termination right or option?

4. If asked to produce rent projections for the next month, quarter or decade, can you generate that report immediately?

5. How many active lease negotiations are in-process? What is their status and who is negotiating the transaction?

6. Do you know what leases have rent increases each month?

7. A legal dispute arises; can you immediately identify the contractor who built out your space two years ago or the broker who negotiated the lease?

8. If your real estate manager left the company, could the replacement employee be in total control of managing your lease obligations starting day one?

These are just a few issues illustrating the importance of having a lease administration system in place. Managing your leases is about managing your contractual obligations and rights. We typically think of our obligations as being centered on paying rent, but there are so many other issues and obligations we need to proactively track. For example, there are insurance requirements, operating expenses, rights of refusal and renewal, maintenance, repairs, relocation, parking, signage, and termination rights just to name a few.

It is well understood within CRE circles that one of the largest expenses for any company is tied to real estate. It should be treated with the corresponding respect. Excel spreadsheets are great for reading reports but are not satisfactory for managing living, dynamic, changing leasehold lifecycles. Lease administration is a term widely used and rarely understood. It can provide powerful strategic insight and be an incredible planning tool, and it all starts with the basic value of organization and risk management. It isn't a question of need, but rather it's the reality of should.

Bottom line: if you have lease obligations integral to your company's operations, you need to manage those obligations thoroughly. Remember, lease administration is not a noun, it is a verb. It is an action, a process you develop to ensure that your rights and obligations are met and maximized.

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