GRANT & LEWIS
Business | Real Estate Services

TAX EXCLUSION:

UNDERSTANDING THE NUANCE OF LANGUAGE

SCENARIO

Consider the case of a national tenant who negotiated a very specific, and highly uncommon, tax exclusion. The clause was specifically negotiated to exclude any tax assessments on highway, street or traffic improvements, including sanitary or storm sewers. Unfortunately, the tax bill was rife with ambiguity and, as is often the case, the landlord's lease administrator did not fully understand the bill's individual line items. Lacking familiarity with the exclusion, the entire tax bill was passed through to the tenant and the error went undiscovered for nearly five years. By the time the tenant's audit process identified the mistake, the problem had ballooned to represent a liability exceeding six figures. Even the largest of property owners will find an unexpected expense of that size tough to swallow.

COMMENTARY

Most commercial lease agreements are structured so that the tenant pays, as additional rent, their share of common area operating expenses, insurance, and real property taxes. Occasionally, in the ever present battle to decrease expenses and increase cash flow, tenants and landlords negotiate specific exceptions to additional rent. As developments expand and market forces result in unique and varied lease agreements it becomes increasingly difficult for lease administrators to manage all of the inherent complexity. In the aforementioned scenario there are a few issues at play.

The first is an all too familiar demon, the compounding of errors over time. When it comes to determining what expenses to pass through to tenants the majority of lease administrators are taught to rely on precedent, subsequently any mistakes are likely to be compounded. When inevitably discovered the landlord is left facing the harsh reality of an unexpected expense. Relying on past decisions might save time in the short run, but far too often serves only to hide errors and reinforce poor processes.

The second issue at hand is the nature of lease negotiations and the nuance of language. In the aforementioned scenario the line item on the tax bill that came into play was a CFD. Because the lease administrator did not understand what that specific line item entailed it wasn't immediately identified as applying to the exclusion. That, coupled with the fact that the exclusion was itself highly irregular created a perfect storm for oversight. Lease agreements are complex and when comforted with uncertainty it is imperative that lease administrators stop to clarify and document the understanding of all interested parties. It is often far more preferable to receive a bill for a few hours of an attorney's time than to let a mistake compound.

Finally it's important for companies to implement controls designed to eliminate, prevent, or minimize mistakes. Some large national tenants rotate lease administrators periodically so as to provide a fresh perspective, landlords would do well to adopt similar procedures. Most importantly landlords need to look at lease language as a method of monetization and if the need arises to give up something of value to a tenant then it is imperative that the concession is as defined as possible. If any of this sounds familiar give Grant & Lewis a call, perhaps we can help.