REAL ESTATE PERSPECTIVES

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Theft By Lease: Electricity Consumption Or Fiction - Or How To Make More Money For The Landlord Without Really Trying

By John B. Wood

Since the costs associated with electricity, water and other services to leased space are becoming a considerable figure, the following thoughts are offered to sharpen the focus when negotiating for space and services. It seems strange to me that one of the most important areas of a lease is the most taken for granted and least understood by landlords, tenants, architects, engineers and lawyers.

Once I tested my theory of the almost total absence of knowledge in the field by negotiating for my client, a very sharp landlord, a roof top space lease for a large very sophisticated mobile telephone company.

Landlord's Cost Or Profit

I decided to take the approach of renting the space, which was raw gravel space, but including in the rent a certain factor or amount which we call the rent inclusion electricity factor, which represented in its simplest form, the price to be paid per square foot for electricity presumably consumed during the year for the transmitters and receivers and other related equipment for this telephone site. I decided to include in that factor a "cost" cushion for administering the billing and a profit factor. I elected to allow the review and adjustment of that figure annually under three scenarios, the first being any change in the rates of the public utility company, the second being any increase in consumption (term of art) of the equipment at the site, and the third being "on occasion", for no particular reason other than if one and two did not catch all changes. The clause worked something like this. The rent was $10.00 a square foot and the rent inclusion factor to be added was $7.00 a square foot. Of course, the actual cost per square foot (for the electricity) was determined to be approximately $4.00 a square foot so the balance was what I refer to as an "extra". The changes in rates by the public utility company servicing the building would cause the rent inclusion factor to be increased in proportion to the percentage increase in the rates. As you know, rates can go up ten to thirty percent a year, as they did in some of those years, and these would be small pennies per square foot of actual additional costs if you figure the actual kilowatt hours consumed at the actual increase in cost per kilowatt hour. However, there was no real correlation between the actual additional costs of the consumed electricity and my formula, which was much more like a porter's wage formula, which increased the rent inclusion factor which also contained my extra. It became apparent after five years when the increases in rates percentage-wise were a bit dramatic and the impact on the $7.00 figure was melodramatic. On the consumption front, it might not surprise you that we had what is called the right to conduct an incremental survey. This works in a unusual manner. When the tenant originally installs its equipment and begins its operation, the landlord comes in and does what is called a survey of the inventory of equipment consuming electricity or which could consume electricity if plugged in and operated within the leased area. If done properly, any equipment in or near the leased gravel whether broken, old, boxed, unboxed, plugged in or not, can be captured and included in the survey from time to time. As one might note in the start-up operation at the end of completion of construction, there is very little equipment hanging around the site that is not plugged in and running. But over the years, many pieces of equipment died or wore out and it was cheaper to leave the equipment in place and bolt a new piece next to the old one or on top of it rather than remove the old one. As with most sites this site had several cooling fans, some compressor equipment and a transformer or two together with a transmitter which were no longer operable, but rather than remove them from the site they were just disconnected.

Charges Only Go Up - Even If You Move Out

Under an incremental survey, any time after the first survey of the premises, the surveyor is instructed, if the clause is written properly and sometimes if not, to inventory all equipment which if plugged in and if operating would consume electricity. Presume it's consuming electricity and presume it consumes it 24 hours a day seven days a week. This is what is called "connectable load" as opposed to "connected and consuming load." Now, the next bit of adjustment comes from assuming all equipment was plugged in and running 24 hours a day, seven days a week, and at its highest electrical needs (or rather demand). Again, if the clause is written creatively enough, one may presume a peak power demand consumption for each piece of equipment. (There are itty bitty red and blue books floating around for engineers to look at which will tell you the normal consumption, peak consumption and demand characteristics of anything made by mankind that consumes electricity.) Our surveyor was very agile in his ability to use his little book and, of course, we priced things that would consume at peak power electricity for only a few seconds in any period of the day, but, of course, we would presume they were consuming at that demand all the time of operation.

If you assume the right at each re-survey to do what's called an incremental survey of connectable load, the scenario further plays out by the surveyor keeping the original survey in place and merely adding to the surveyed amount those new pieces of equipment that are being used or that are on the site and sitting around whether or not connected. The old pieces which were obviously no longer working or which were no longer at the site were not deducted from the survey amount. So the survey, of course, is something that incrementally grows and, due to changes in rates and charges of the public utility and the assumptions of the characteristics of consumption, the charge turns into a monster. The logic of this type of electrical consumption bears no resemblance to the actual cost of the electricity consumed by the equipment at the site, you might observe. That is wonderful, but this observation must occur prior to signing the lease. This type of electricity clause is merely a profit vehicle for the landlord if properly drafted and properly administered.

The Fine Art Of Triple Dipping

This last statement of cost takes into account something we have not yet discussed, that is, the possibility that the sum of the rent inclusion electric factors of all tenants in the building and for those spaces which should be tenantable and charged accordingly may already equal or exceed the entire building electricity charges. If it doesn't, add it together with the electricity consumed for the common areas such as lobbies, air conditioning systems and mechanical rooms, but excluding other areas which are not to the benefit of all tenants-in-common such as garage and retail space, and this should equal the charge that should be assessed evenly throughout the tenants in the building. Of course, that number minus any work done in the premises by landlords in order to improve, repair or decorate the premises for current or future tenants should also be deducted. Careful attention has to be given to what portions of the electrical, gas, water or other natural resource allocation goes on between tenant's use in its premises and its reimbursement of landlord for operating expense escalations or utility reimbursement or surcharges. One can envision some landlords obtaining reimbursement from between one and a half and three times the entire building electric meter by way of rent inclusion factors, escalations and direct charges for overtime services. One might also understand that after hours heating, ventilating and air conditioning as well as special elevator charges all have a component of labor materials and electricity. If all of those plus after hours lighting and rent inclusion electric factor reimbursements are taken into account, it's a clear picture on what the cost of electricity for public areas, operating expense escalation and demised premises should be. This is not an answer, it is a provocation.

Secure Tomorrow's Needs Today (It Will Cost Less!)

There are other interests of the tenant other than just cost of electricity. With change in electricity and power consumption needs of sophisticated tenants, the big questions, in addition to how much it costs, are how much do I need today, how much will I need tomorrow and will I be able to obtain additional power in the building as my needs and technology change. This is not a simple question, and is rarely voluntarily addressed in the affirmative in a lease. The norm is that electricity is granted by capacity at the time of construction, and that capacity is the minimum that landlord feels it can get away with per usable square foot in the building. Future needs are not guaranteed, and if they are satisfied by a landlord, it is generally with additional sizeable costs and profit factors included. Also if the particular use, which may be unusual and power intensive, is not described in these clauses, it may be prohibited anyway. Ask what is there, what you can get, how much it costs, where it comes in, when it comes in and will it be available later if you need more. When I say where it comes in, one must be careful to understand that electricity may be delivered to the floor and it may be delivered in 25 different locations. When a tenant takes overall space, one does not necessarily know where the feeders and junction boxes are.

Whose Electricity Am I Paying For Anyway!

Beware of the premises where you rent a floor and find out that your rent will be increased by an electricity charge that is by way of submetering. You must not assume rates or proper submetering of only consumption in the demised premises.

One should also consider what amount should be paid during the construction period. If the landlord is doing a build-to-suit, and is otherwise delivering a turn-key at landlord's cost, electricity and other general conditions should also be at landlord's cost.

There are other arguments such as the issues relating to discontinuance of furnishing electricity on a rent inclusion basis. This should not be allowed unless the landlord is compelled by law or public service utility regulation to discontinue.

If Landlord Fries Your Computers Why Shouldn't Landlord Pay?

Landlord generally will exculpate itself or limit its liability for loss or damage or inability to use the premises sustained by reason of failure, inadequacy or defect in the character, quantity or supply of electricity or other raw materials to the premises. Many jurisdictions allow this complete exculpation and it is imperative to the practitioner to cause it to be limited to those things not within the control of landlord, or caused by landlord's acts or negligence.

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