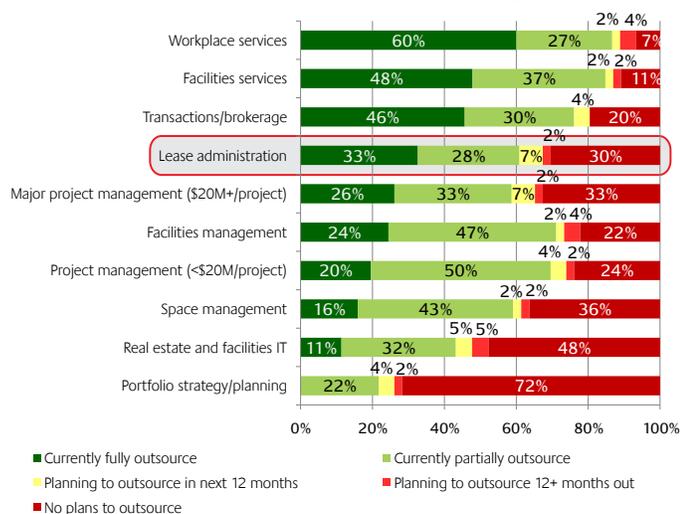


Companies' drivers for, and against, outsourcing lease administration

by Steve Silen, Director, KPMG Advisory Services

As with any front-, back- or mid-office business process, there are many reasons companies choose, or opt against, outsourcing as a delivery model for real estate and facilities management (REFM). To gain insights into topics including current REFM market trends and conditions, and global REFM sourcing trends, among others, KPMG in late 2011 conducted its first annual REFM Outsourcing Pulse Survey. Figure 1 below presents the results of buy-side organizations' responses to a survey question posed on current and planned REFM outsourcing levels

Current and planned REFM outsourcing levels



As you see, fully outsourcing all of lease administration is the most common operating model (33 percent of respondents), followed closely by no plans to outsource any of lease administration (30 percent of respondents.) While the cumulative responses "current fully outsource," "currently partially outsource," "planning to outsource in next 12 months," and "planning to outsource 12+ months out" far exceed the "no plans to outsource" responses, there are very legitimate reasons why some organizations choose in-house delivery of their lease administration processes. Let's take a look at the drivers behind adopting both of these models.

Examples of lease administration activities outsourced or performed in-house include:

- Lease abstracting
- Data entry and administration of lease documents, including document scanning
- Lease administration database
- Invoice review and payment processing – rent, common area maintenance (CAM) charges, taxes, etc.
- Accounting, including budgeting, forecasting and variance analysis
- Portfolio analysis and performance reporting
- Critical date reporting/tracking
- Annual landlord reconciliation statement review
- Lease auditing
- Landlord relationship management, including handling issues/disputes
- Subtenant administration, including collecting money due
- Tenant improvement allowance administration

Reasons firms decide to outsource all or portions of lease administration

Most organizations outsource lease administration because their in-house team was not meeting expectations, or because they believe they will achieve better performance through an outside firm. While the specific reasons vary from company to company, examples include:

Staffing/Expertise

Lease administration is not a core activity for their firm, so they do not want to staff, or fully staff, the function. They lack commercial real estate experience, and have no intention of building that skill set in-house. They do not want the burden of recruiting, training and managing an in-house staff, nor do they want to invest time and resources to operate the function. They want their in-house staff to focus on strategic real estate activities, as opposed to tactical lease administration activities. Finally, outside providers are subject matter experts, understand lease administration, and have proven track records, and therefore can likely be trusted to perform lease administration activities better than in-house staff.

Process Improvements

Outside providers have better processes, platforms and controls than they do internally, including ability to scrutinize payments, promote consistency across the portfolio, improve the quality of lease abstracts, and perform audits. They want accurate and easily accessible lease administration data, better governance of the overall process, transparency, and improved reporting and KPIs, and they feel these can best be accomplished through outsourcing. Finally, they believe issues will be more effectively communicated to landlords, and that landlords will be more responsive to their needs when dealing with a professional lease administration firm.

Risk Mitigation

There is greater comfort level that required activities will be performed appropriately, as the outside provider has proven processes from handling lease administration for many clients. In addition, third party providers will ensure that the necessary controls are in place to meet contractual obligations and avoid business risks, as their revenue stream and reputation are important for their survival and they do not want sub-optimal performance to negatively impact them. Additionally, outsourcing mitigates concerns about loss of knowledge when in-house employees leave their firm, as providers often have a pipeline of qualified “on the bench” team members and the ability to get new staff quickly up to speed on their processes.

Cost Savings

Outsourcing will enhance their ability to reduce/avoid costs, and improve their ability to recover money, avoid rent overpayments, detect errors, and ensure money owed is properly identified and tracked until receipt. Further, outsourcing provides a flexible/scalable staffing model as providers can easily flex up or down as the size of the real

estate portfolio changes. Additionally, outside providers have systems and technology specifically designed for lease administration, and continue to invest in them to remain competitive, thus eliminating buyer firms’ need to allocate funds to purchase and maintain their own systems.

Leading Practices

Outside providers are more likely to introduce leading practices and better promote continuous improvement as they serve many clients. They must also continually monitor trends and be ready to accommodate changes such as Financial Accounting Standards (FAS) 13. Buyer organizations believe that if the function remained in-house, they would not get beyond status quo and would risk being out of step with what peer firms are doing.

Reasons firms are against outsourcing all or portions of lease administration

They believe that lease administration is best performed by their in-house staff, and there are no significant risks to operating this way. Again, the specific reasons vary from company to company, but examples include:

Scope/Scale

They do not have a large leased real estate portfolio, so their lease administration activities are minimal and can be easily handled by their in-house staff. In fact, it may not even be a full-time activity.

Performance/Control

Their current operating model is very inexpensive. They have evaluated the cost to outsource lease administration and determined their costs would be higher if outsourced, or the financial prize would not be significant enough to warrant a change. They are satisfied with current performance. There have been no operational glitches, and all required activities are being performed. They do not believe that any opportunities are being missed, including money being left on the table. They do not want to give control of their lease administration data to an outside firm. They believe they can best manage the confidentiality of the information and minimize business disruption risks by keeping the function in-house.

People

Their in-house staff is on site, accessible, and can help with other real estate activities, whereas the outside provider is likely offsite and would not be able to perform activities beyond the scope of the outsourced contract. Their in-house staff can be controlled better than an outside firm, and will be more responsive to last minute requests, meeting tough deadlines, working overtime, and multi-tasking – especially if that is the corporate culture. Their in-house staff knows the organization’s internal structure and policies, corporate politics, company culture, and who to contact within the company/department better than an outside provider. Additionally, they do not want their in-house staff to lose their jobs, so are not open to considering outsourcing, despite the possible benefits.

Timing

Finally, while they do not disagree that outsourcing may be better, they have other more important, current priorities to address.

Which operating model is better?

It depends on the circumstances – size of the portfolio, complexity, level of expertise, process maturity, costs, risk/exposures, etc. While there are many potential advantages to outsourcing, what may be the right option for one company may not be for another. My recommendation is to let the facts determine which operating model is better for your company. Rather than pre-judging, conduct an analysis that includes:

- Understanding your current state – activities performed, staffing, costs, processes, technology, strengths/weaknesses, etc.
- Evaluating your current state and identifying opportunities for improvement
- Understanding the marketplace – provider capabilities, current trends and benchmarking
- Identifying and evaluating options to improve your current state, whether through in-house enhancements or outsourcing
- Developing recommendations to improve your current state
- Building a compelling business case to obtain endorsement of your recommendations
- Developing plans to implement the changes

It's important to use specific criteria in order to objectively evaluate your current state versus other options. As a starting point, I recommend using the evaluation criteria outlined in the KPMG paper, [Creating the Right Team to Select a Facilities Management Service Provider](#). While not specifically designed for outsourcing lease administration, it will help you develop evaluation criteria for this function.

If the analysis shows that continuing to perform lease administration services in-house is best, you should certainly continue to do so. But if it points to outsourcing, you'll be well-served by investigating your external options, as outsourcing lease administration is neither high risk nor a new phenomena, and there are many qualified firms that offer lease administration services.

Whichever model you ultimately select, it's important that lease administration activities be performed in an effective and controlled manner by qualified people. If not, you face myriad potential problems, including:

- Uninformed decisions
- Ineffective management of the portfolio
- Higher costs
- Overpayments

- Missed payments
- Penalties for late payments
- Failure to recover all monies due
- Missed dates and opportunities (e.g., the option to turn back floors at no penalty)
- Non-compliance with lease terms, FAS, Sarbanes-Oxley, etc.
- Inaccurate, incomplete data
- Difficulty accessing information
- Inaccurate, insufficient reporting
- Loss of key documents
- Legal issues and potential liabilities
- Business disruption

For many firms this can be costly, particularly for organizations with a significant lease administration portfolio. Regardless of size, it is important that the right lease administration operating model be selected and that it operate properly.

Leveraging third-party consulting support is often beneficial to lead the overall process, from the analysis of the current state all the way through implementation of changes, as it provides assurance that all of the required steps are properly performed in an objective manner.

Conclusion

Outsourcing of lease administration is very common, and has delivered quality results for many firms. But there is no right or wrong answer as to whether lease administration should be outsourced. What may be right for one company may not be right for another. Rather than blindly following the pack, you should evaluate what is right for your firm.

The end result may be minor enhancements to your current operations, or a major overhaul. Either way, it is worth the time to assess the health of your current state and improve it, whether that means moving to an outsourced model or enhancing your in-house operations. The consequences of not doing so can be costly.

For information and research on outsourcing, shared services and internal improvement, visit the KPMG Shared Services and Outsourcing Institute at <http://www.kpmginstitutes.com/shared-services-outsourcing-institute/>



About the Author

Steve is a Director within KPMG's Shared Services and Outsourcing Advisory practice. He has an excellent track record across the full life cycle of Real Estate and Facilities Management, including strategic asset planning, portfolio optimization, shared services, outsourcing, and business process assessment and improvement initiatives.

Steve Silen

T: +1 951 852 8140

E: ssilen@kpmg.com

Contact KPMG Shared Services and Outsourcing Advisory

Americas

Houston
Tel: 1 713 319 2000

Europe, Middle East and Africa, Asia Pacific

London
Tel: (020) 7311 1000

*For country, industry and service-specific
contacts, please visit: [www.kpmg.com/
Global/en/Pages/contactus.aspx](http://www.kpmg.com/Global/en/Pages/contactus.aspx)*

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