

Welcome



Paul Noetzel
Managing Director, Asset Services
(512) 370-2422
Paul.Noetzel@cushwake.com

Before We Start

- Interaction is expected
- I may call on you
- Turn off your phone
- Stay focused
- Have a Good Time Learning!
- TREC - MCE Credit at end
- Acknowledgements for Data

Agenda

1. Overview

- What are Expense or CAM Reconciliations?

2. Getting Started

Gather what is needed

- Lease Information
- Current & Prior Information

3. Lease Types

4. Expense Types

5. Controllable vs. Non-Controllable Expenses

6. What are Expense CAPS?

7. Grossing Up Expenses

- Working Examples

8. Timeline

9. Q&A



1. OVERVIEW

What is it?

What is a CAM Escalation or Reconciliation? What is a Gross-Up? And Who Cares?

Operating Expense Rent or Common Area Maintenance (CAM) rent is carefully defined in the lease. The lease clauses dealing with CAM expense spell out in detail what building expenses the owner is allowed to “pass through” or “escalate” to the tenants. There are many terms for the operating expenses that the tenants pay according to the terms of their leases this includes: pass through operating expense, escalatable operating expense, reimbursable operating expense and CAM.

The theory and mechanics of incorporating occupancy adjustments (gross-ups) into the year-end operating expense amounts

Gross-Up: A lease clause that allows the Landlord to increase recoverable expenses that vary with occupancy to an amount that would be incurred if a defined level of occupancy were achieved. Gross-up clauses typically allow the Landlord to gross-up variable operating expenses to 95% or 100% occupancy. (ReaLogic)



2. GETTING STARTED

What is Needed?

Tenant & Lease Information

Lease Type

Occupancy Info

- Square Footage
- Days of year leased

Expense Pool Essentials

- NNN
- Base Year
- Base Amount or Expense Stop
- Caps
- Gross-Up Language

What is Needed?

Accounting Information

What is generally needed & Where can you find the information?

- General Ledger – YTD (detailed)
- Rent Rolls: January - December
- Tenant Ledger or Receivables for year (w/detail by charges)
- YE Income Statement (w/sublines)
- Prior Year's OPEX
- Leases
- Accounting Software to be used
(Kardin, MRI, Alpha Office Escalation, Excel or Other)

Getting Started

- Depending on the company, the Real Estate Management staff is normally tasked with completing the OPEX calculations
- Make notes re: adjustments you make to the GL (items paid in current year for prior year)
- Determine adjusted expense pool(s), starting with year-end income statement balances
- Update all schedules on reimbursable capital expenditures



3. LEASE TYPES

Types of Leases

Net Lease

Gross Lease

Modified Gross

Base Year

Expense Stop

Net lease

Net Lease

Full or True Triple Net
(NNN)

Gross Lease

Gross Lease

Expense Stop
Base – Base Year



4. EXPENSE TYPES

Expenses

**Operating
Expenses**

**Non-Operating
Expenses**

Real Estate Taxes

Insurance

**Capital
Expenditures**

Operating Expense Types



Repair, Maintenance & Operations



Administrative & Management Expenses



Parking



Insurance



Other

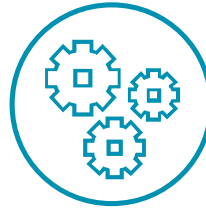
Operating Expense Types



Repair, Maintenance & Operations

- Utilities
- HVAC
- Elevator
- Janitorial
- Landscaping
- Security
- Snow & Trash Removal
- R&M Contracts

Operating Expense Types



Administrative & Management Expenses

- Administrative payroll
- Management office rent
- Copiers
- Management Fees
- Various consultants for the property

Fees related to management of the property

Operating Expense Types

Parking Expenses

- Parking Garage Expenses
- Cleaning
- Striping
- Property Taxes & Insurance



Operating Expense Types

Other Types of Expenses

- Tax Consultants
- Code Change Compliance
- Governmental Expenses / Fees
- Licenses
- Other Taxes



Capital Expenses

Expenses that may be capital in nature can be included as part of operating expenses

“If” allowed in the lease

“If” there is some cost savings

Capital Expenses

Improvements for cost savings can be passed through

Consider how to recover

- All in one year
- Amortized over a period



5. CONTROLLABLE VS. NON-CONTROLLABLE EXPENSES

Controllable vs. Non-Controllable

Controllable Expenses

Utilities	Yes / No	Janitorial	Yes / No
HVAC	Yes / No	Management Fee	Yes / No
Repairs & Maint	Yes / No	Administrative	Yes / No
Elevator	Yes / No	Insurance	Yes / No
Landscaping	Yes / No	Property Taxes	Yes / No
Security	Yes / No		

Controllable vs. Non-Controllable

Controllable Expenses

Utilities	Yes / No	Janitorial	Yes / No
HVAC	Yes / No	Management Fee	Yes / No
Repairs & Maint	Yes / No	Administrative	Yes / No
Elevator	Yes / No	Insurance	Yes / No
Landscaping	Yes / No	Property Taxes	Yes / No
Security	Yes / No		

A hand holding a pen is writing on a document. The document features a bar chart with several vertical bars of varying heights. The background is a warm, yellowish-orange gradient with faint, stylized network graphics consisting of circles and connecting lines. The text "DISCUSSION ON EXPENSE CAPS" is overlaid in a bold, dark blue font.

DISCUSSION ON EXPENSE CAPS

A close-up photograph of a person's hands working on a desk. One hand holds a pen, pointing at a document with a bar chart. The other hand is also pointing at the same area. A calculator is visible in the foreground, and a yellow sticky note is on the left. The document has various tables and charts, including one titled 'CURRENT SAVINGS AND FUTURE'.

6. WHAT ARE EXPENSE CAPS?

Who Benefits?

Expense Caps

- **Percentage Cap**
- **Caps Based on Costs**
 - Based on Individual Accounts
 - Based on Sum of Accounts
- **Cumulative Caps**
- **Year-over-Year Caps**

Annual & Cumulative Caps

Examples

COMPARING: ANNUAL CAP vs. CUMMULATIVE CAP

Year	Actual Expenses	Annual % Increase	5% ANNUAL Cap		5% CUMMULATIVE Cap		Annual Difference
			Cap Limit	Allowable	Cap Limit	Allowable	
1	100,000			100,000		100,000	
2	105,000	5.00%	105,000	105,000	105,000	105,000	0
3	105,000	0.00%	110,250	105,000	110,250	105,000	0
4	108,000	2.90%	110,250	108,000	115,763	108,000	0
5	120,000	11.10%	113,400	113,400	121,551	120,000	6,600
6	127,500	6.30%	119,070	119,070	127,628	127,500	8,430

Represents the increase in allowable CAM that can be collected = 15,030

Think of it this way

Annual Cap

Each Year's Maximum
Expense Cap

=

Last Year's Allowable
Expense Times $(1.X)$

X = the cap expressed as a decimal (5% is 0.05)

Cumulative Cap

Each Year's Maximum
Expense Cap

=

Base Year's Expense Times
 $(1.X)^n$

$Cap = Base Amount * (1+X)^n$

X = the percent n = the number of years



HANDOUT:

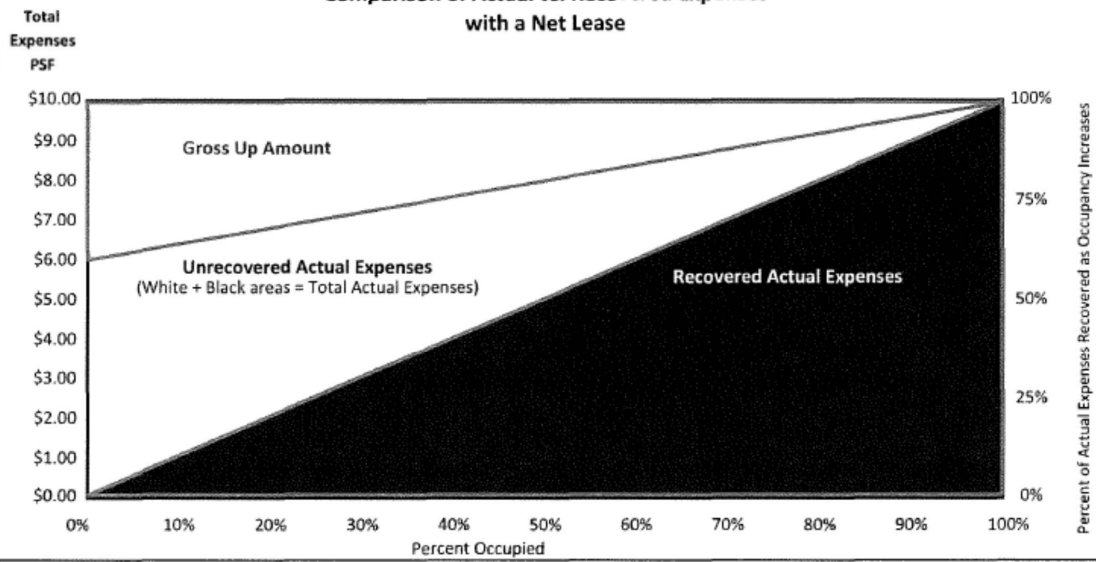
Controllable Aggregated vs. Non-aggregated Basis



7. GROSSING UP EXPENSES

Exhibit 4-1

Operating Expenses
Comparison of Actual vs. Recovered Expenses
with a Net Lease





HANDOUT:
Janitorial Gross Up



HANDOUT:

Electrical Gross Up



HANDOUT:

Management Fee Gross Up

A low-angle, upward-looking photograph of several modern skyscrapers with glass facades. The buildings are reflected in each other, creating a complex geometric pattern. The sky is visible in the background, and the overall color palette is dominated by blues and greys.

DISCUSSION:

What other expenses might be grossed up?

Samples from Excel



ACTIVITY:
Time to put information to use.

Working Calculations

Examples



8. TIMELINE

Property Manager

- **Be aware of critical lease deadlines**
- **Keep complete & final calculations**
- **Obtain owner/asset manager approval, if required**
- **Create invoices for the tenants**
- **Draft cover letter to tenants**
 - Suggest adding quick notes to tenant letter on expenses & reasons for variance to initial estimate

Audits

- Audits may be completed by either the client or tenant
- If a tenant, for any reason, suspects the lease has not been administered correctly, an audit may be requested and completed
- For this reason, complete and accurate records must be maintained
- Tenants' right to audit are disclosed in the lease with language specifying the location and scope of the audit
- Written notification should be obtained
- A Confidentiality Agreement should be signed by the tenant

9. Q&A



Acknowledgements

SOURCES

- Institute of Real Estate Management (IREM) irem.org
- Alpha Office Escalation alphaofficeonline.com
- Realogic Analytics realogicinc.com
- Various Internet Searches
- Esteemed Colleagues & Accountants

Thank you!



Paul Noetzel
Managing Director, Asset Services
(512) 370-2422
Paul.Noetzel@cushwake.com